State of Rhode Island Accountants and Auditors Institute
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Operational Risk Management- More than an insurance policy

William K. Austin
Principal and Consultant
Austin & Stanovich Risk Managers LLC
401-751-2644
wkaustin@austinstanovich.com
www.austinstanovich.com

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Objective for today's session

Create and/or heighten the "risk awareness" of State, City and Town auditors to become better eyes and ears for State, City and Town **risk managers.*

**Your organization may not have a formal risk manager-it may be a person charged with insurance procurement. Your eyes and ears may help broaden their abilities and move from "insurance manager" to "risk manager"*

Your Take-Aways for the next 90 minutes

- Understand the risk management process and how use of insurance may be an appropriate part of the process.
- See risk management as a strategic process.
- Add value to your “audit customers” by incorporating a risk management awareness to your audit process.
- Look for insurance coverage issues before loss.

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Background on Speaker

- VP/Corporate Risk Manager FleetBoston Financial: Oct. 1994 to May 2002.
- Insurance broker: SVP-Risk Management Services-Rollins Hudig Hall of RI (Now known as Aon Risk Services): May 1986 to Oct. 1994.
- AVP/Staff Consultant: Albert Risk Management: January 1983 to May 1986.
- Commercial Underwriter: Wausau Insurance Cos. (Wausau, WI and New England) January 1977 to January 1983.

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Background on Austin & Stanovich Risk Managers LLC

Practice areas

- Risk management and insurance consulting to organizations.
- Expert Witness and Litigation support.
- Risk management and insurance consulting to agents and brokers: add bench strength/technical expertise-not sales.

Industry Expertise

- Construction
- Education-primary/secondary/higher
- Financial services/Banking
- Government-municipal and state
- Healthcare
- Manufacturing
- Non-profit and religious entities
- Oil/heat

100% consulting services-no insurance sales

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Define “Auditor”

- What is the role of an Auditor for the State, a City or a Town?
- Why would an Auditor be interested in Operational Risk Management?
- Should the audit process look at risk management practices and use of insurance whether the audit if “financial” or “process”?

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The World of Risk Management

- Risk is risk-isn't it?
- Pure risk defined: "chance of loss only"
- Speculative risk defined: "chance of loss or gain"
- "Risk" defined for our purposes today"
    - Chance of loss
    - No chance of gain
    - Uncertainty concerning loss

Risk Management-Defined

A common definition:

"*To protect an organization's assets through identifying and analyzing exposures to loss; controlling the exposures; financing of losses with external and internal funds; and implementing and monitoring the overall process*".

Austin's definition: "*An adverse event, activity or outcome that may increase cost of an organization's operating expense and/or the cause a loss of revenue*".

Purchase of insurance is not Risk Management

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Enterprise
Risk Management-Defined

Enterprise risk as "an organization's management of hazard, operational, financial, strategic and reputation risk."

- Hazard – loss from fortuitous events, either natural or manmade, such as fires, earthquakes, windstorms, theft, or icy roads.
- Operational - loss from operational failures, such as failure of quality control, the cost of product recall, or failure to comply with regulations or laws.
- Financial - loss from changes in asset quality, risk of dealing in a foreign currency, or the risk of extending credit to customers or vendors.
- Strategic - loss caused by business decisions, such as the development and sale of new products or services or the acquisition or divestiture of assets or operations.
- Reputation – loss due to the decrease in the value of an organization's name, brand, product or service.

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Case Study #1

An electrical fire caused by improper wiring by electrical contractor that was low bidder.

3 weeks after competitive bid situation a fire occurs in renovated portion of middle school.

Why may have this happened?

What risks should have been managed differently?

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Different risks-same outcome

Causes of electrical fire from improper wiring installed
By the lowest bidder may be:

- **Hazard** risk (fire)
- **Operational** (improper wiring)
- **Strategic** (low bids win, outdated building codes).

May create reputational risk for organization:
School not seen as safe thus leading to
reputational issues of school board

May create reputational risk for individual:
No confidence in School Board: Loss of votes at next
election

Operational and Hazard Risk:
The Risk Management Process

- Identify exposure/risks of loss including quantification of loss
- Determine available techniques, i.e. risk management tools
- Evaluate techniques for most appropriate-single or several
- Implement best techniques
- Monitor/Improve

The Risk Management Process:
I. Exposure Identification

Loss exposures-what can happen to assets, people, employees, etc.

- Complete a survey form or review prior application of insurance.
- Review financial statements.
- Tour facilities “managing risk by walking around”.
- Discussion with peer group.
- Use of “experts”.

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The Risk Management Process:
II. Determine potential techniques

A. Risk Controls

- Avoidance
- Loss prevention-frequency
- Loss reduction-severity
- Segregation of loss exposures
- Contractual transfer to other party

The Risk Management Process:
II. Determine potential techniques

B. Risk Financing

- Retention of loss (deductibles, etc.)
- Risk Transfer: contractual by hold harmless/indemnification agreement
- Commercial insurance
- Pooling-e.g. Interlocal Trust

The Risk Management Process: III. Evaluate appropriate techniques

Effective: meets the goals and objectives of the organization (consider loss sensitivity: risk adverse)

Economic: least expensive whether single technique or in combination with others

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The Risk Management Process:
IV. Implementation of best technique(s)

Implementation the chosen technique(s)

- Risk control-loss prevention (automatic sprinklers)
- Risk financing-hold harmless/indemnification
- Risk financing-retention (expense expected loss)
- Risk financing-purchase commercial insurance

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The Risk Management Process:
V. Monitor the risk management program

All organizations are dynamic-some more than others. If nothing else the legal environment changes.

Risk management process needs regular overview of exposure to loss, current techniques used and need for change/improvement

Case Study #2

The school board has been approached by ABC Transport for a possible "out-sourced" school bus service.

You are on the school board. How does risk management enter into the decision making process?

The Risk Management Process:
Insurance-an appropriate risk financing technique

Insurance Policies are Contracts.

"What the large print giveth the small print takeh away".

RTP: Read the Policy

Insurance policy ambiguity is usually in favor of the Insured

Litigating insurance coverage is not an efficient use of insurance as a risk financing technique.

Ask Coverage Questions!

A basic property an casualty insurance checklist

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Disclaimer:

The following checklist is not to be considered the rendering of legal or professional services.

The checklist is simply to point out common errors and omissions found in insurance policies. It may not be complete for all types of policies and it may not address issues related to your organization's insurance program.

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Basic Insurance Checklist:
All property and casualty insurance policies

Any "NO" answer should be referred to risk manager/insurance manger. An uncertain answer should be treated as "NO".

- Is the policy underwritten by an insurer that has an adequate financial rating such as A. M Bests and at least A VI?
- Is the named insured written to correctly identify your organization?
- Is Notice of occurrence condition when insurance manager or risk manager be made aware of circumstance that may lead to loss covered by policy?
- If premium is subject to exposure audit (i.e. receipts, payroll, vehicles) does your organization accrue for possible premium due at policy expiration?

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Property insurance checklist

- Is there a reasonable methodology used to estimate insurable values for building and contents?
- Is the deductible per loss reasonable for exposure and premium?
- Is there a need for business interruption coverage such as loss of business income and/or extra expense coverage?
- Are perils insured "all risks of loss" including flood, earthquake and equipment breakdown?
- Are losses settled on a replacement cost basis?
- Have co-insurance clauses (insurance to value) been removed by waiver or agreed amount endorsement?

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General liability insurance checklist

- Are all locations, activities or operations included for coverage? (Look for endorsements that take away basic coverage)
- Does the policy occurrence and aggregate limits satisfy the umbrella/excess liability policy?
- Are appropriate entities or individuals included as additional insurers?

Automobile liability and physical damage insurance checklist

- Does the policy provide liability coverage either by Symbol 1-“for any auto” or Symbols 7,8,9-”for any scheduled, hired or non-owned auto”?
- Are all vehicles insured for physical damage-comprehensive/collision? (If not, why?)
- Does the policy occurrence limit satisfy the umbrella/excess liability policy?
- Are appropriate entities (i.e. leasing companies) identified as loss payees and as additional insurers?
- Are all registered vehicles of the organization insured by this policy? (If not, where is coverage?)

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Worker's compensation

- Is the organization required to obtain workers compensation insurance?
- Is there a policy in place?
- If optional, should the organization consider compliance with WC statute instead of being subject to tort liability?
- Does the employers liability limit satisfy the umbrella/excess liability limit?

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Other considerations

- Is there crime insurance for
  - dishonest acts of employees
  - theft of cash, checks and negotiable instruments
  - forgery/alteration
  - computer fraud
  - fraudulent funds transfer

- Is there an umbrella/excess liability policy to provide catastrophic limits for tort/negligence to third parties?

- Does the organization have an environmental insurance policy for spills of hazardous materials including seepage from above/underground fuel storage tanks?

- Is there a public official bond in place for each pubic official of the organization as required by Rhode Island statute?

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Case Study #3

General discussion:

What risk and/or insurance issues have you encountered for your organization?

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