Risk Management Division

Guide for Section 13.1 – Risk Management and Self-Insurance Premiums 2011-2013 Budget

A. Purpose

This Guide provides an overview of Enterprise Risk Management (ERM) basics. ERM is included in the 2011-13 Budget Instructions for *Section 13.1- Risk Management and Self-Insurance Premiums*. The ERM basics covered in this Guide are provided to foster common understanding about its core principles and practices for finance, risk, or other managers involved in addressing *Section 13.1-Risk Management and Self-Insurance Premiums* of the Budget Instructions.

B. Key ERM Terms Defined

The following section provides a list of key ERM terms and definitions.

Risk

Risk is defined as anything that poses a potential barrier to an agency achieving, on time, its mandated and strategic objectives/goals.

Risk Management

Risk management refers to the practices an agency uses to manage its risks.

Enterprise Risk Management (ERM)

Enterprise risk management is a coordinated method used to identify, evaluate, prioritize, and respond to all the risks that could stop an agency from successfully reaching its goals on time. This coordinated approach can create cost savings and enhance agency efficiency by identifying and deploying resources where they can best impact the success of agency goals and action plans. *Note: Governor Gregoire has declared ERM to be an agency best practice to be integrated with all planning, strategic, and decision-making processes.*

Enterprise Risk Management Maturity Model

The ERM Maturity Model is a self-scoring measurement tool that agencies use annually to assess their progress in implementing ERM. The elements of the Maturity Model also help agencies set risk management goals and recognize achievements. *Note: Contact your agency risk manager or* *designated risk management coordinator for more information about the Maturity Model.*

Loss History

An agency's loss history contains information about agency losses in certain categories, including reported incidents, tort claims, and lawsuits. OFM collects data in these categories to compile reports that detail agency losses.

Risk Identification

Risk identification is the structured process through which an agency analyzes its goals to determine every possible barrier that might prevent the agency from achieving the goals over a specified time period. There are many different methods for identifying risks, including the use of focus groups and surveys.

> *Example*: An agency wants to identify risks to achieving its goal of decreasing employee automobile crashes by 20% by the end of FY 2011. The agency identifies its risks by inviting a cross section of agency personnel to a workshop, during which time the participants brainstorm about every possible barrier to reduction of employee crashes through FY 2011.

> *Example*: An agency wants to identify risks to achieving its goal of reducing unscheduled employee absences through CY 2010. The agency risk manager prepares a questionnaire that will be sent to each agency employee. The questionnaire suggests a few examples of risks associated with the goal, and that also asks for the employee to provide any other risks to the goal that s/he may be aware of.

Risk Evaluation

Risk evaluation is the process through which identified risks are prioritized based upon how likely they are to occur, as well as the impact on achieving a goal if the risk event actually happens.

In ERM, all the risks to meeting a goal are evaluated using a 1-5 scale that shows how likely a risk is to happen and a 1-5 scale to show how much impact a risk event would have on a goal if it did happen. The two numbers are multiplied to assess the severity of each risk.

> *Example*: An agency has identified three risks associated with a goal. Each risk is evaluated using a chart:

Risk	Likelihood (1 = low, 5 = high)	Impact (1 = low, 5 = high)	Assessment (LxI)
#1	3	4	12
#2	1	5	5
#3	5	4	20

> This process leads to a prioritization of the risks based on their severity: in this example the seriousness of each risk are, in order of priority, Risk #3, Risk #1, and Risk #2.

Heat Map

Heat maps are used to graphically depict a risk evaluation. The graph charts likelihood against impact. Risks that fall into the red zone are priority risks that need immediate attention.
The graph chart clearly displays each serious risk, and is useful as a tool to help organizations plan their risk management activities.

Example: The heat map below is based on the data in the previous chart:

HEAT MAP	1 Very Little	2 Minor	3 Major	4 Critical	5 Fatal
5 Almost Always				Risk #3	
4 Frequent					
3 Often				Risk #1	
2 Once or Twice					
1 Hardly Ever					Risk #2

The "red zone" risk is Risk #3. *Note:* under this analysis, Risks #1 and #2 would be considered the same level of priority.

Risk Treatment

Risk treatment (also often called "risk mitigation") is a process for planning the best actions to address high priority risks. There are four basic means of risk treatment: Avoid, Accept and Monitor, Transfer, or Reduce the Likelihood or Impact.

1. Avoid: this reflects a decision to no longer engage in the risk-related activity.

   Example: Due to losses associated with the operation of a particular facility, an agency may decide to close the facility.

2. Accept and Monitor: this reflects a decision to take no action with regard to the risk-related activity at the current time, but to carefully monitor the risk area.

   Example: Although an agency operation might be severely affected by extreme weather, an agency will decide to continue its operations but will carefully monitor weather conditions.

3. <u>Transfer</u>: an agency will arrange, either through insurance or by contract, to transfer the impact of a risk to another party.

> *Example*: An agency is going to build a large office complex. Risks involved with the construction project will be transferred through certain contract provisions, as well as through the purchase of certain insurance policies.

4. <u>Reduce the Likelihood or Impact</u>: this reflects a decision to take steps to mitigate/reduce how often a risk-related event might happen, or the impact of such an event.

> *Example*: An agency may increase its safe driver training program to reduce the likelihood of employee automobile crashes. Similarly, an agency might restrict the purchase of automobiles in its fleet to those that have airbags, to reduce the impact of the crashes.

<u>Self-Insurance Premium</u>

The Self -Insurance Premium is the premium paid by the agency to fund the State of Washington Self-Insurance Liability Program (SILP). SILP pays tort liability indemnity and tort defense costs.

C. Agency Implementation of Enterprise Risk Management

It is widely recognized that it takes several years to successfully implement Enterprise Risk Management within an organization. Each Washington State agency is at a different stage of implementing ERM, and is therefore at a different maturity level. Some are just beginning to talk about ERM and how it might benefit them, while a few are nearly at the mastery level of ERM maturity. Most agencies are somewhere between these two extremes.

It is understood that there are agencies at the beginning or exploratory stages of ERM implementation and will not have a program that includes more mature ERM activities such as risk identification, assessment, mapping, etc. Responses to §13.1 of the Budget Instructions should reflect the actual ERM experience at the agency.

D. Resources for Addressing Loss Trends and Analysis (Items 1-3)

Loss history (claims experience) is used by the State's actuary to develop the funding requirements for the Self-Insurance Liability Program (SILP) account. Agencies are assessed a premium based on their individual loss history (i.e. the total of all paid claims, reserves and the change in value of claims) for the *prior six years*. Section 13.1 requires agencies to address both past and future loss trends. Frequently asked questions are addressed below.

2011-2013 Budget Preparation Information and Resources
Question and Answers Section

What Claims Experience Time Period is Used in the 2011-2013 SILP Premium Assessments?	The 2011-13 biennial Self-Insurance premium and defense costs were allocated to agencies using the 6-year loss history—2003 through 2009.
What is the RMD web site link for requesting loss history reports on-line?	The web site can be accessed at the following link: http://www.ofm.wa.gov/rmd/budget/default.asp. On the risk management budget page, click on **"Loss History Report for Analysis"** for the request form screen. Reports will be distributed electronically to the requester—generally the same day as the request.
Who Do I Call If I have questions about loss history data or how it can be used to complete Section 13.1 as pertains to ERM?	• *If you have questions about making a loss history report request or interpreting the results, please contact:* **Lucy Isaki** at lucy.isaki@ofm.wa.gov or 360-902-3058. • *If you have questions about ERM or the ERM method analysis (risk assessments, heat maps, and the maturity model), or workplace safety initiative goals and activities, please call* **Drew Zavatsky** at drew.zavatsky@ofm.wa.gov or 360-902-9813. • *If you have questions about Self-Insurance premium assessments, please call* **Claudia Schmitz** at claudia.schmitz@ofm.wa.gov or 360-902-7306.
Do privacy considerations apply to Section 13.1?	**Yes. Do not include confidential information in Section 13.1.** It is **important that agencies not include any confidential information** in Section 13.1. Please do not use **names or other confidential information** when discussing goals, measures, accountability projects or outcomes related to systems, processes, practices and programs.

I've reviewed Executive Order 01-05 but it does not indicate "typical" risk areas. Do you have a list of such risk areas?	Yes. Risk categories that often inform the risk identification process for agencies include: • Financial/budget Risk • Business Risk • Reputation Risk • Operational Risk • Safety/Security Risk • Audit Risk • Legal Risk • Regulatory/Compliance Risk • Document Management Risk • Demographic/Succession Risk • Strategic Risk