

	<b>Page</b>
(c) Consideration of criteria for the assessment of RM projects together with some examples of initial worthwhile schemes. (4 marks – A 2, R 2)	
□ Acknowledgement that, initially at least, RM funds will be limited and bids are likely to exceed the finances available.	11,13,16,26
□ A comment that schemes are likely to fall into two main categories –	
• General – concerned with profile-raising, training etc. and therefore benefiting all Ministries;	26
• Specific – targeting a particular risk or risk area with a specific solution.	16,26
□ In assessing bids, many criteria could be used including –	
• The breadth of impact and effectiveness of general schemes;	
• The requirement for specific schemes to be aimed at claim reduction;	
• Justification through the assessment of likely pay-back;	
• The willingness of Ministries to match-fund schemes being put forward;	
• A preference for one-off funding rather than ongoing revenue schemes.	
□ Comment that risk management monies should not be seen as a means of enhancing normal operational funding.	
□ A note that there needs to be a formal approval process with successful bids signed off at a senior level.	
□ Examples of general projects –	
• Formal training through consultants;	
• Exhibition involving both internal (Health & Safety, Occupational Health, Fleet Manager, Emergency Planning, Trading Standards) and external (police, fire etc.) preventative staff;	
• Written communication – newsletters, posters;	
• Prizes - Staff suggestion scheme etc.	
□ Examples of specific projects –	
• CCTV;	
• Smoke/fire alarms;	
• Specific training to reduce particular risks;	
• Security fencing	
• Increased inspection.	
(d) Presentation, format, tact and general readability. (2 marks – P 2)	

## 6. Question 4

- (a) To test candidates' ability to create a budget for the Internal Insurance Fund (IIF) from the figures given and to comment upon its viability;
- (b) To test their ability to analyse the implications of pricing proposals being made in respect of the SLA charge for claims handling and;
- (c) To test their competence in carrying out a Cost Volume Profit (CVP) exercise on the data provided to test the sensitivity of the pricing proposals put forward;
- (d) To test their ability to explain simply the CVP approach and to interpret the results;
- (e) To examine candidates' competence in drafting a short report for the Divisional Management Team.

*Assessment*

- (a) Brief explanation and background to the introduction of the IIF, and the a note on the operation of the IIF as regards both income and expenditure. (3 marks – A 3)
- Note of the legal framework for the creation of the IIF. 1
  - An explanation of the main purpose and key advantages of setting up the IIF – 2,3,8,19
    - To take control of smaller claims that form the majority of claims submitted (1,600 out of 1,800);
    - To leave external insurers with just the major risks (high cost and catastrophe);
    - To place a far greater emphasis on and to encourage risk management (RM) through a raising of awareness and a RM improvement programme; 3,11
    - To reinvest IIF surpluses partly in risk management measures to assist Ministries in areas where there are known problems; 13,16,26
    - To build up a surplus on the IIF which ultimately results in reduced premiums and more expenditure on front-line services. 3,11
  - A note on the operation of the IIF as regards income – 13
    - Ministries will still be charged premiums to cover claims on the IIF;
    - These premiums will be based upon a breakdown of the existing insurance quantum plus an allocation for inflation in 2005/06;
    - These premiums will now be allocated to Ministries on the basis of claims experience (over the last three years) 13
    - Ministries will also pay for RM and claims handling costs –
      - RM - a flat rate fee into the IIF 13
      - Claims handling – a charge per claim into the IIF; 13
    - The total payable by Ministries will equal the premiums payable in 2004/05 plus an inflation allowance; 4,11,13,15
    - The basis of charge for claims handling and RM will be incorporated into a Service Level Agreement (SLA) with Ministries. 4,13,16
  - A note on the operation of the IIF as regards expenditure –
    - All settled claims below the external insurance excess limits will be charged to the IIF; 4,13
    - All costs of claims handling by the Ministry and risk management will be charged to the IIF; 4,13,16
    - There will be a provision to fund risk management improvements in the Ministries. 4,13

- (b) Calculation of income and expenditure budgets in respect of the various elements forming the IIF and production of a summary overall budget for the years 2005/06, 2006/07 and 2007/08, together with comments upon the results achieved. (9 marks – C 7, R 2)
- A note of the internal premiums to be charged in respect of claims (excesses). 13
  - Calculation of the SLA charges for RM and claims handling
    - The fixed amount to be charged for risk management
    - On claims handling, the calculation of the charge per claim<sup>1</sup>.
  - Determination of likely IIF claims expenditure through an updating of the 2004/05 claims history base to take account of -
    - Expected inflation of 15% in 2005/06;
    - The reductions in claims in 2006/07 and 2007/08 as a result of the risk management initiatives undertaken.
  - Determination of the costs of the extended Insurance and Risk Management Section that is to operate from 1 April 2005 through -
    - Calculation of the staffing costs (including pay oncosts)<sup>1</sup>;
    - The addition of the office and central oncosts at 60% of staffing costs.
  - Determination of the likely legal costs incurred in respect of IIF claims<sup>1</sup> through -
    - The calculation of the number of claims requiring legal input;
    - On this basis, the calculation of the number of hours of legal input required;
    - The calculation of the cost per hour based upon a combination of internal legal input to claims (75%) and the use of external lawyers (25%) at the differential rates.
  - A note of the allocations to risk management improvement projects. 27
  - The collation of the income and expenditure figures for the three years.
  - The determination of the net position in each year.
  - A note that, on the basis of the assumptions reflected in the figures, -
    - 2005/06 produces a small deficit;
    - This is more than offset by the surpluses in 2006/07 and 2007/08;
    - The future position looks reasonably healthy on the back of continuing surpluses.
  - A note of caution about the assumptions underlying the budget figures produced -
    - Income is largely fixed;
    - The cost of claims and legal advice can be volatile and could vary from previous norms.
    - However, the cost of claims is capped at an aggregate £1.5 million by the external insurance arrangements.
  - A thought that expenditure on risk management improvements might have to be approached cautiously until -
    - The pattern of claims is established each year;
    - A sufficient surplus is built up in the IIF to provide a contingency against the unexpected.

**NOTE** For suggested calculations see Appendix 4A, but note comments in 1(e) above.

<sup>1</sup> On the basis of 1,600 claims per annum

(c) Sensitivity analysis on the recovery of claims handling and risk management services in 2005/06 through the SLA charging policy proposed, using Cost Volume Profit (CVP) analysis, together with an interpretation of the results and an explanation of the methodology. (16 marks – C 12, A 2, R 2)

- In terms of income, a note of –
  - The flat fee for risk management;
  - The charge per claim for claims handling;
- In terms of expenditure, determination of –
  - The fixed costs relating to the rest of the newly extended Insurance and Risk Management Section.
  - The stepped fixed costs as regards administrative and clerical support on claims handling;
  - The variable cost per claim on legal input;
- Determination of the “trigger points” for the stepped fixed costs and calculation of the stepped costs at each “trigger point”.
- A calculation showing for each “trigger point” –
  - Total income – fixed plus variable;
  - Total expenditure – fixed plus stepped plus variable;
  - Net surplus/deficit.
- The presentation of this data in graph form, appropriately annotated.
- The determination of the breakeven points and the relevant range
  - Break-even point 1 = 1,605 claims;
  - Break-even point 2 = 1,842 claim;
  - Relevant range – 1,605-1,842.
- A simple explanation of the methodology, the terms used and the technique’s limitations.
- A simple interpretation of the results
  - If the number of claims falls below 1,605, the recovery rate of £250 per claim is insufficient to recover costs and a deficit is incurred;
  - If the number of claims rises above 1,842, the recovery rate of £250 per claim more than recovers costs and a surplus results;
  - Between 1,605 and 1,842, there is rotation between deficit and surplus.
- Conclusions
  - Delaying the additional administrative and clerical support “triggers” until nearer 1,800 claims would keep any deficit to a minimum;
  - Otherwise, some uplift in the charge per claim might be required to break-even.

**NOTE** For suggested calculations see Appendix 4B, but note comments in 1(c) above.

(d) Presentation, format, tact and general readability. (2 marks – P2)

## QUESTION 4

				£	PAGE
<b>1. Risk Management &amp; Claims Handling Charges (SLA)</b>					
Quantum				460,000	13
Risk Management - Charge per Ministry	4	@ £15,000		60,000	13
Claims handling				400,000	
Balance to be recovered				460,000	
Claims handling - Charge per claim	Claims =	1,600		£250	19,27
<b>2. Claims Expenditure</b>					
				2005/06 £	2006/07 £
				£	2007/08 £
Base 2004/05				840,000	840,000
Inflation (to 2005/06 price base)	@ 15%			126,000	126,000
				966,000	966,000
Reductions through risk management					
2006/07	@ 3%				28,980
2007/08	@ 8%				77,280
				966,000	937,020
				888,720	27
<b>3. Cost of Extended Section <sup>2</sup></b>					
Staffing (on the basis of 1,600 claims)					
Insurance & Risk Manager	1	M3	£40,000	40,000	13,17
Insurance Officer	1	SO2	£31,000	31,000	13,17
Risk Management Officer	1	SO2	£31,000	31,000	13,17
Administrative Assistants	5	Scale 3	£18,500	92,500	13,17
Clerical/Filing Assistant	1	Scale 1	£13,500	13,500	13,17
				208,000	
Office and Central Oncosts	60%			124,800	17
				332,800	
<b>4. Legal Costs <sup>1</sup></b>					
Number of claims	1,600	@ 10%		160	17,27
Average Hours		@ 10	Per claim	1,600	17
Average cost per hour					
Internal advice	£30 per hour	@ 75%		£22.50	17
External advice	£230 per hour	@ 25%		£57.50	17
				£80.00	
Cost	1,600 hours	@ £80		128,000	

**Marks Allocation**

Income (1)	- 1 mark
Income (2)	- 1 mark
Expenditure (3)	- 1½ marks
Expenditure (4)	- 1½ marks

<sup>2</sup> All costs are on the basis of 1,600 claims per annum

## QUESTION 4

	2005/06	2006/07	2007/08	PAGE
	£	£	£	
<b>8. Summary IIF Budget</b>				
<u>Income</u>				
Internal premiums	1,035,000	1,035,000	1,035,000	13
Risk Management & Claims Handling Administration (SLA)				
Risk Management Charge	60,000	60,000	60,000	
Claims handling	400,000	400,000	400,000	
	<u>1,495,000</u>	<u>1,495,000</u>	<u>1,495,000</u>	
<u>Expenditure</u>				
Internal claims	966,000	937,020	888,720	
Cost of Section	332,800	332,800	332,800	
Legal Costs	128,000	128,000	128,000	
Risk Management Improvements	70,000	95,000	120,000	27
	<u>1,496,800</u>	<u>1,492,820</u>	<u>1,469,520</u>	
	1,800	-2,180	-25,480	

**Marks Allocation**

Summary – 2 marks

## QUESTION 4

PAGE

**1. Fixed Costs**

			£	
Extended Section			332,800	
Less Administrative Assistants (£29,600)	5	148,000		13,17
Less Clerical Assistant (£21,600)	1	21,600	169,600	13,17
			163,200	

**2. Step Fixed Costs**

		Per FTE	Oncosts	Total	
Administrative Assistant	(Salary + oncosts @ 60%)	18,500	11,100	29,600	17
Clerical Assistant	(Salary + oncosts @ 60%)	13,500	8,100	21,600	17

**3. Variable Costs**

Legal costs	£128,000	for 1,600 claims	
Cost per claim			£80

Number of Claims						
1300	1400	1401	1600	1700	1701	1900
£	£	£	£	£	£	£

**4. Stepped Costs**

Administrative Assistant							
Number	4	4	5	5	5	6	6
Cost at £29,600 per FTE	118,400	118,400	148,000	148,000	148,000	177,600	177,600
Clerical Assistant							
Number	1	1	1	1	1	1.5	1.5
Cost at £21,600 per FTE	21,600	21,600	21,600	21,600	21,600	32,400	32,400
Total Stepped Costs	140,000	140,000	169,600	169,600	169,600	210,000	210,000

**5. Net Summary for Varying Claim Levels**

Income							
Fixed (Risk Management)		60,000	60,000	60,000	60,000	60,000	60,000
Variable (Claims handling)	@ £250 per claim	325,000	350,000	350,250	400,000	425,000	475,000
		385,000	410,000	410,250	460,000	485,000	535,000
Expenditure							
Fixed		163,200	163,200	163,200	163,200	163,200	163,200
Stepped		140,000	140,000	169,600	169,600	210,000	210,000
Variable	@ £80 per claim	104,000	112,000	112,080	128,000	136,000	152,000
		407,200	415,200	444,880	460,800	468,800	509,280
Net Cost		22,200	5,200	34,630	800	-16,200	24,030
						-9,800	

**Marks Allocation**

Fixed Costs	– 1 mark
Step Fixed	– 1 mark
Variable Costs	– 1 mark
Tables	– 3 marks

**QUESTION 4**

PAGE

**6. Determination of Breakeven Points for the Relevant Range**

Where P = Number of Claims

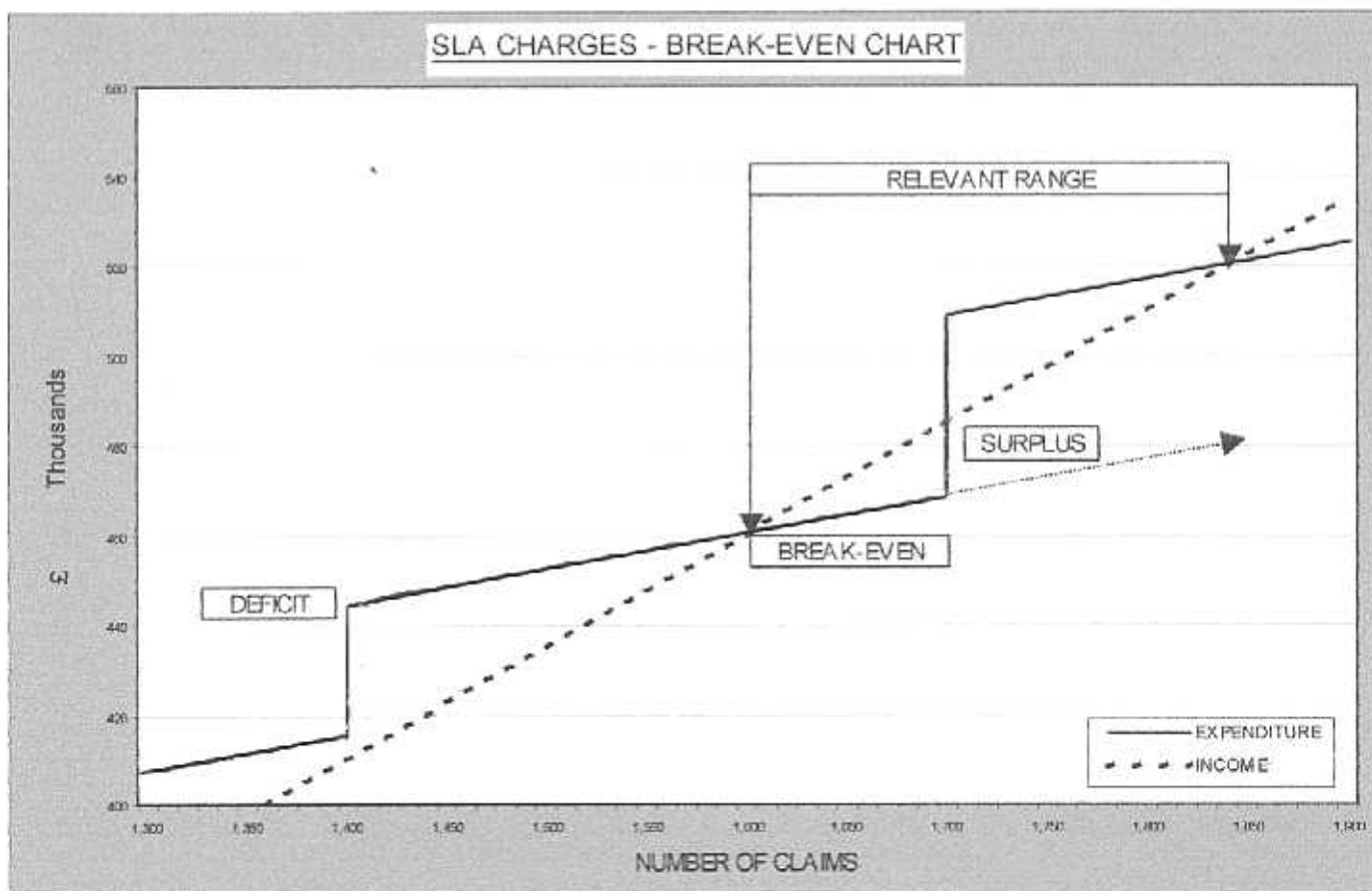
Break-even point (0) =

$$(Fixed\ Income - Fixed\ Cost) - Stepped\ Fixed\ Cost + (Variable\ Income \times P) - (Variable\ Costs \times P)$$

First point  $(60,000 - 163,200) - 169,600 + (250P - 80P) = 0$   
 $-103,200 - 169,600 + 170P = 0$   
 $170P = 272,800$  1,605 Claims

Second Point  $(60,000 - 163,200) - 210,000 + (250P - 80P) = 0$   
 $103,200 - 210,000 + 170P = 0$   
 $170P = 313,200$  1,842 Claims

**7. Breakeven Chart**



<u>Marks Allocation</u>	
Break-even Points	- 3 marks
Chart	- 3 marks