RISK MANAGEMENT AND BOOKKEEPING SYSTEMS[1]

Second in a Series

by Harry A. Carpenter

Risk Management

Risk management may be defined as the art and/or science of anticipating and controlling all elemental, inherent, and environmental hazards that could cause financial loss and determining the most efficient means of financing such loss. In establishing an effective Risk Management program, it is first necessary to be aware of the consequences that may result from the existence of loss-causing hazards. They are: 1) damage to or loss of property, 2) loss of income from damage to property or additional cost of alternative means to continue services, 3) money damages arising out of negligent acts resulting in bodily injury or damage to property of others, and 4) loss of service due to death or incapacity of key personnel.

Risk is uncertainty. The underlying theme of risk management is that any business enterprise faces the possibility of loss. While the particular loss and severity varies among types of organizations, each one faces loss-causing risks that can reduce income and/or destroy efficiency. Three fundamental rules of risk management are: 1) Don't risk more than you can afford to lose. 2) Don't risk a lot for a little. 3) Consider the odds.

An organization's governing principle should be to protect its assets from attrition due to fortuitous losses by: 1) eliminating risks wherever possible, 2) reducing the effects of risks which are economically unfeasible to eliminate entirely, 3) assuming or self-insuring (as a charge against operating expenses) losses from risks not considered significant in relation to cash flow, and 4) transferring risks to another party contractually, or purchasing insurance for risks not otherwise transferred. Of these methods, No. 4 (transferring risk by the purchase of insurance) is the most common. When risk is transferred to an insurance company, the buyer should receive from the insurance company not only loss-paying ability but also other services, such as loss prevention engineering and claims adjusting facilities.

Of the four methods involved in protecting assets from attrition, the best alternative should be chosen for each risk of loss. The key decision is to determine which risk management technique will contribute most to the Company's objectives.

The purchase of an insurance policy creates an immediate funding device for future losses. It is essential that the policies include coverage for all insurable losses. The goal of covering all insurable type losses depends on current market conditions.

In certain circumstances foreseeable losses may be of such small magnitude that no effort should be made to finance them. Deductibles are customarily utilized to avoid dollar-trading with insurance companies. Since the insurance company determines its ultimate premiums on the basis of class losses plus an overhead charge factor, the elimination of small inconsequential losses from insurance coverage reduces the cost of that insurance.

The use of deductibles is common in the property and time element areas. Generally speaking, deductibles are not used in the liability areas because it is essential that the insurance company be involved in a liability claim from the first dollar upward in order to control the defense of the case.

One recommendation is that all your insurance policies restrict the cancellation privilege of the insurance company by requiring at least 60 days (preferably 90 days) prior notice of cancellation or non-renewal. When risk is transferred to an insurance company, the buyer obtains loss paying ability as well as other services such as loss

1. Presented at the annual conference of the International Society of Arboriculture in San Antonio in August 1986.

prevention engineering and claims adjusting facilities. The following four basic benefits should be expected from an insurance company:

- Respond promptly and adequately at time of loss. The ability of an insurance company to perform at time of loss depends on the coverage in the policy. The response is a contractual obligation and if the policy is adequate, the response will be adequate.
- Property conservation advisory services designed to prevent or limit the effect that inherent hazards may have on property, including its earning potential. In this regard the insurance company is considered to be an expert in prevention of loss. The value of prevented loss is inestimable.
- The transfer of the buyer's risk at a cost commensurate with the degree of loss potential and frequency thereof.
- Assurance that the insurance market will be available long into the future.

The relationship between an independent agent and the various insurance companies represented is complex. The agent attempts to maintain a balance with the various companies placing sufficient good business with each to keep each one happy, yet maintaining a market for the less attractive risks. The insurance buyer is rarely a part of this operation, but is substantially affected by it. An agent with a predominantly good book of business will be able to serve an insurance buyer better than an agent with a poor book of business. In effect, the agent is a customer of the insurance company and the insurance buyer is a customer of the agent.

This is not to imply that an insurance company operating through an agent does not pay specific attention to an individual buyer's needs. The insurance company assists the agent in helping the buyer and is most able to provide good coverage at nominal cost if the insurance agent maintains a good relationship with the insurance company. It goes without saying that no insurer will continue to provide insurance over a long period of time for a situation that shows signs of deterioration.

The relationship between an insurance company and an insurance buyer is tantamount to a joint venture. The success of the joint venture centers on the ability of the insurance buyer, working with loss prevention personnel of an insurance company, to effectively control all preventable type losses.

There are no hard and fast rules to be applied in the selection of an insurance source. The relationship is a personal one and must fit the personalities of the parties involved. Of paramount importance are the insurance company's loss paying abilities, ancillary services offered, and contractual provisions within the policy.

Insurance Costs

Liability insurance premiums are influenced by *individual* loss experience modified by the impact of inflation as related to the cost of goods and services, as well as the claims consciousness of the American public, coupled with higher jury awards. When a large sum of money is awarded by a jury to an injured party, the out-of-court settlements of other claims have a tendency to rise proportionately. Thus, the total cost of claims increases.

Property insurance premiums have consistently been influenced by *overall* loss experience independent of the losses sustained by a specific insured.

Reinsurers in the world insurance marketplace influence primary insurance premiums drastically. There probably has been no other time in recent insurance history when the effect of reinsurance has been as visible. Reinsurance allows the primary insurance company to increase capacity and maintain availability. The "banking" aspect of reinsurance expects the primary insurance company to eventually reimburse the reinsurance company for all losses and expenses paid out.

The fall of 1984 became the visible turning point of insurance premium levels. Reinsurers began to demand higher premiums for their insurance and these costs were passed down to the primary insurance companies. As reinsurance treaties expired in 1985, some treaties were not renewed and others commanded reduced limits and increased premiums. In 1986 insurance costs are practically out of control and the amount of coverage drastically reduced. This general trend in curtailment of the insurance market has precipitated the premature termination of established insurance programs by companies that have decided to retire from certain classes of business (such as schools and governmental bodies).

It is anticipated that a shortage of insurance capacity will persist for the next eighteen months to two years. The change in capacity will result because of new investment moneys flowing into the insurance industry attracted by anticipated profits. This should stabilize insurance costs and may even precipitate another round of price reductions to the advantage of the buying public.

Bookkeeping Systems

Reasons to maintain accurate books and records are to:

- Keep track of transactions with others
- Supply potential lenders with accurate financial data
- Comply with government regulations
- Detail taxable income

The accounting and information needs of your business must be analyzed to determine the best bookkeeping system. The particular system you adopt should provide the following:

- Detailed operating statements
- Comparison of current results to budgets and prior periods (where and when available)
- Financial statements suitable for use by management and creditors
- Information for tax returns and reports to regulatory agencies
- Sufficient control to protect assets and detect errors

Components of a Good Bookkeeping System. Each business has special needs that must be considered when establishing a bookkeeping system. Factors you should take into account when determining the specific areas of operation in your bookkeeping system include: the form of business, the industry in which you are engaged, the number of employees, the number of product lines (services), the number of business locations, and the complexity of your business.

The company's accounting records should consist of the following:

- Chart of accounts
- General ledger
- Sales and cash receipts journal, detail accounts receivable cards and aged accounts receivable trial balance
- Cash disbursements journal
- Purchase journal and detail vendor payable cards
- Payroll journal
- General journal
- Fixed assets ledger
- Inventory stock record control
- Bank reconciliations, including deposit receipts
- Monthly financial statements

Chart of accounts. A chart of accounts serves as an index to the general ledger accounts. Each ledger account is identified by a number and the ledger. A chart of accounts is a convenient way to summarize and categorize transactions.

General ledger. The general ledger contains all of the accounts of the company. Monthly totals are accumulated by summarizing the various journals in which individual transactions have been recorded during the month. Financial statements are prepared from the information in the general ledger.

Sales and cash receipts journal. A sales and cash receipts journal is used to record all incoming cash. An accounts receivable aged trial balance should be prepared on a monthly basis.

Accounts receivable entries should be posted to the appropriate customer's detail accounts receivable card. These cards list the initial customer sale amount and the respective customer payments on that sale, giving a balance due at any one time. These cards should be maintained alphabetically by customer name.

Cash disbursements journal. This journal is used to record all checks written. The check number, date, payee, and amount should be entered in check number order. At the end of each month, the cash disbursements journal totals should be posted to the appropriate general ledger accounts.

Purchase journal. All vendor invoices, that are not paid directly as the material is purchased or services are performed, should be recorded in the purchase journal. The journal will show the invoice date, vendor, amount, and classification of the account distribution for each invoice or group of invoices.

The total amount of each vendor invoice should be posted to the detail vendor accounts payable cards. At the end of each month, the purchase journal should be totaled and posted to the appropriate general ledger accounts.

An accounts payable listing should show the accounts payable as of the month-end.

Payroll journal. Payroll information is summarized in the payroll journal. This consists of hours worked, pay rate, gross pay, deductions, and net pay. Employee record cards need to be maintained for each employee.

Personnel files should be maintained on a current basis for all employees. These files should contain all employee information, such as deduction authorizations, withholding status, and properly approved pay rate forms. All changes to pay rates should be properly approved and documented in the files. This will help prevent the loss or misplacement of documents and help prevent error in computing the various payroll taxes and miscellaneous deductions.

General journal. The general journal is used to record transactions that do not logically fit into the cash receipts, purchasing, or cash disbursement journals.

General journal entries can be classified in one of two categories—recurring and nonrecurring. Recurring entries are those that are made monthly, such as the entries to record depreciation expenses, accrued liabilities, and adjustments to prepaid expense balances. A standard journal entry should be used to record the recurring entries. Nonrecurring journal entries are those made to record unusual transactions, such as the correction of errors in the general ledger accounts.

Fixed assets ledger. Detail records for all real and personal property should be prepared and updated monthly to ensure that reliable information on such assets is readily available. A depreciation lapsing schedule may be used as the detailed fixed asset record. The lapsing schedule should include the following information for each asset:

1. Complete description, including identification number
2. Date acquired and purchaser's name
3. Estimated useful life
4. An indication of whether the asset was purchased new or used
5. Purchase cost, including freight, set-up charges, special writing or other costs necessitated by the acquisition of the asset
6. Depreciation method
7. Accumulated depreciation to date

Inventory stock record control. This file should contain a card on every major inventory stock item identifying purchases of that item with corresponding dates and prices. Also included on the card should be a list of removals of that item from the inventory by date and respective price.

Inventory procedures should be established to get complete and accurate physical inventory counts on a regular, periodic basis. Where discrepancies exist between physical inventory and the records, adjustments should be recorded in the general journal.

Bank account reconciliations. Bank reconciliations should be prepared monthly on a timely basis, reviewed for unusual items and reasonableness, and then approved in writing by the treasurer. Bank account reconciliations should be performed by persons other than those preparing checks, posting ledgers and journals, and signing checks. A file should contain copies of all bank reconciliations.

Financial statements. Financial statements should be prepared monthly for financial management purposes. A copy of the financial statements should be filed in a permanent file each month to serve as a record of the progress and financial position of the company.

All of these areas should be considered when determining the bookkeeping system and records needed by your business. Do not underestimate your system needs. Bookkeeping can be time consuming and should be carefully analyzed at the beginning, so that you do not choose a system that you outgrow tomorrow, or one that does not lend itself to your needs.

Who Should Keep the Books?

The entrepreneur has several options when deciding who should be responsible for the company's books and records.

- The owner-manager can keep his own books. However, you may have to spend weekends and evenings doing the books while weekday hours are spent managing the business.
- Hire a bookkeeping service.
- Hire a bookkeeper.
- "One-write" systems.

• Service bureaus and computer systems.
• In-house computer systems.

A good bookkeeping system is essential to run a business profitably. The financial information requirements of the business must be analyzed carefully to determine that the bookkeeping system chosen for your business is appropriate and supplies the necessary information. Where the business is simple, a manual system may be sufficient. Where the business is more complex and, consequently, the business decisions require more extensive financial data, an accountant should be consulted to determine the best system for your business and its needs.

ACRT, Inc., Environmental Specialist
152 East Main Street
P. O. Box 209
Kent, Ohio 44240

Abstracts

New York State Nurseryman Assn. 1986. **How to help plants survive a drought.** Landscape Contractor. June p18-19.

The simple procedures discussed here will both conserve the existing supplies of water and add new sources at little or no cost. The best technique to conserve moisture in the garden is a three-inch layer of mulch around the base of plants. Mulches protect the soil from direct sunlight and air currents, which helps reduce the amount of water evaporation. In rainy periods, mulching prevents soil erosion and reduces water runoff. Mulches also add to a property's value. Anti-dessicants are products which form a protective coating over the foliage of plants, thereby reducing up to 80% the rate of evapo-transpiration. Wilt-Pruf and Vapor-Guard, two well known products, can be safely used on herbaceous and woody plants or even on turf. Weeds are one of the greatest competitors for moisture in soil. The best weed control is a pre-emergent herbicide combined with a mulch. Plants lose virtually all the water they draw from the soil through their leaf surfaces. To help prevent this loss, prune trees and shrubs to reduce their leaf surface.

Skiera, B. and G. Hennen. 1986. **Solving sidewalk problems.** Am. Forests 92 (6): 10-14.

The conflict between roots and sidewalks has been going on as long as there have been sidewalks. Most people would agree that both trees and sidewalks are good assets to any community and that neither should be banished for the sake of the other. Fortunately, a little common sense and forethought can prevent battle lines from being drawn in the first place. Most of the people empowered to solve the conflicts between trees and sidewalks know a great deal about concrete and little about trees. In order to reverse this situation, two things are needed: knowledege of trees and sidewalk construction options and the political savvy to apply that wisdom to the problem. Property owners can exert control over trees by preparing for and attending town meetings. Having a professional on hand during construction projects provides another opportunity for homeowners to protect trees. An understanding of soils and root growth is important to proper sidewalk installation. Where soils are predominately clay and the concrete slab is laid directly on the subsoil surface clay, tree roots will intrude at the soil surface directly under the slab. It is only a matter of time before these roots increase in diameter and cause sidewalk heaving. Futile efforts to fit trees into available space are perhaps one of the most costly aspects of urban forestry. Seldom are trees selected for their compatibility with tree-lawn size or with their potential for sidewalk destruction in mind at the time of planting. There is no substitute for the right tree in the right place.