

Activity 1—Describing the Purposes of Hazard Risk Management Cost Allocation Systems

Complete the following table by briefly describing how an effective hazard risk management cost allocation system promotes each of these features.

Topics	Answers
1. How does an effective hazard risk management cost allocation system promote risk control?	
2. How does an effective hazard risk management cost allocation system help to facilitate risk retention?	
3. How does an effective hazard risk management cost allocation system help to prioritize risk management expenditures?	

<p>4. How does an effective hazard risk management cost allocation system help to reduce costs?</p>	
<p>5. How does an effective hazard risk management cost allocation system help to distribute costs fairly?</p>	
<p>6. How does an effective hazard risk management cost allocation system help managers to balances risk bearing and risk sharing?</p>	

<p>7. How does an effective hazard risk management cost allocation system help managers by providing cost information?</p>	
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Answers for Activity 1—Describing the Purposes of Hazard Risk Management Cost Allocation Systems

Complete the following table by describing how an effective hazard risk management cost allocation system promotes each of these features.

Questions	Answers
1. How does an effective hazard risk management cost allocation system promote risk control?	<ul style="list-style-type: none"> • Primary purpose of cost allocation systems is to allocate costs of actual or potential losses to responsible departments • Each department is held accountable or rewarded for risk control efforts
2. How does an effective hazard risk management cost allocation system help to facilitate risk retention?	<ul style="list-style-type: none"> • Departments are not unduly exposed to excessive fluctuations in their cost of risk, which encourages higher risk retention
3. How does an effective hazard risk management cost allocation system help to prioritize risk management expenditures?	<ul style="list-style-type: none"> • Assigning responsibility for risk management costs helps departments prioritize risk management expenditures within departments • Departments more carefully scrutinize cost-effectiveness or risk controls • Prioritizes efforts based on return on investment
4. How does an effective hazard risk management cost allocation system help to reduce costs?	<p>Greater risk control prevents or reduces losses</p> <p>Risk retention is optimized</p> <p>Optimization of expenditures frees up resources which can be redirected to other risk control efforts</p>
5. How does an effective hazard risk management cost allocation system help to distribute costs fairly?	<p>Creates a direct correlation between departmental loss costs and departmental cost of risk</p> <p>Reduces tension between departments</p>
6. How does an effective hazard risk management cost allocation system help managers to balance risk bearing and risk sharing?	<p>A risk-bearing system is responsive to loss control efforts and creates a direct correlation between a department's loss exposures and the</p>

	<p>amount of risk, but does not distinguish between avoidable risk and unavoidable risk</p> <p>A risk-sharing system stabilizes risk management costs across departments</p> <p>A blend of the two systems is optimal because the risk-bearing system is responsive to loss control efforts, but unavoidable risks are spread more evenly through a risk-sharing system</p>
<p>7. How does an effective hazard risk management cost allocation system help managers by providing cost information?</p>	<p>Compels managers to focus on areas in which the cost of risk can be reduced or controlled more effectively</p> <p>Accurate information leads to better risk management</p> <p>System can be used to set clear incentives based on performance</p> <p>Should not be susceptible to manipulation by departments or by senior management</p>

Types of Hazard Risk Management Costs to Be Allocated

Activity 1—Allocating Hazard Risk Management Costs

In this activity, you should complete this table so that you can easily compare the types of hazard costs that can be allocated to departments and the type of hazard costs that should be allocated to overhead across the entire organization.

Category of Hazard Risk Management Cost	Allocate to Departments	Allocate to Overhead
Costs of accidental losses not reimbursed by insurance or other outside sources		
Insurance premiums		
Costs of risk control techniques		
Costs of administering risk management activities		

Answers for Activity 1—Allocating Hazard Risk Management Costs

Category of Hazard Risk Management Cost	Allocate to Departments	Allocate to Overhead
Costs of accidental losses not reimbursed by insurance or other outside sources	<ul style="list-style-type: none"> • Most accidental loss costs not reimbursed by insurance or other outside sources can be apportioned to the responsible department that generated the loss. • Loss adjustment expenses such as legal fees and debris removal that can be allocated to a particular claim should be allocated to the specific department as well. • Loss adjustment expenses such as the expenses associated with using a third-party administrator could be wholly or partially allocated to departments based on the direct loss costs. • Risk charges should be allocated based on the other direct loss costs. • Claims cost can be allocated on an incurred basis or a paid basis. 	Costs that cannot be attributed to a specific department should be allocated to overhead and spread across the organization as a whole. However, some of these costs can still be allocated to departments as a percentage of direct loss costs. Any losses or loss costs that are not directly allocated to specific departments should be included in overhead and charged to the organization as a whole.
Insurance premiums	Premiums are generally fixed for a policy year and can usually be attributed directly to a department. For example, aircraft product liability premiums can be allocated directly to a department that	Certain coverages, such as directors and officers liability insurance, provide a more general benefit for the entire organization and should be allocated to overhead.

	manufactures aircraft or aircraft components. Workers compensation premiums and fire insurance premiums are also easily allocated to departments.	
Costs of risk control techniques	Most loss control expenditures are clearly allocable to a particular department and would include items like fire suppression or detection equipment, safety shoes for workers, and driver training courses.	Costs that are may not be easily attributable to a particular department might include an organizational safety audit or a consultant's report.
Costs of administering risk management activities	<p>Costs incurred by that department or that can be accurately attributable to specific departments, which might include these costs:</p> <ul style="list-style-type: none"> • Salary and benefits for people working in workers compensation claim administration departments and the cost of their furniture, supplies, and other needs. • The portion of the risk management professional's salary and benefits that represents the time that person spends on the workers compensation program for each department. 	<p>Costs that are more appropriately allocated to overhead would include these:</p> <ul style="list-style-type: none"> • Consultant's audit of risk management department performance • Actuarial services • Captive insurance company management fees

Prospective and Retrospective Cost Allocation

Activity 1—Distinguishing Between Prospective Cost Allocation and Retrospective Cost Allocation

Put a checkmark in the appropriate column to indicate whether each statement applies to the prospective type of cost allocation or to the retrospective type of cost allocation.

Questions	Prospective	Retrospective
1. In this type of cost allocation, once the costs are allocated, they do not change and are thus known with certainty.		
2. The primary advantage of this type of cost allocation is a stable budget.		
3. This type of cost allocation results in delayed allocations that make risk management budgeting becomes more complicated.		
4. The primary advantage of this type of cost allocation is that costs are more accurately attributed to the period and the department with which they are associated.		
5. A disadvantage of this type of cost allocation is that increases or decreases in risk control activities are not recognized right away.		
6. In this type of cost allocation, estimated costs are allocated at the beginning of the accounting period during which they are expected to be incurred.		
7. In this type of cost allocation, the primary emphasis is on actual versus potential loss experience.		
8. A disadvantage of this type of cost allocation is that actual costs can differ substantially from those costs that are actually allocated.		
9. A disadvantage of this type of cost allocation is that final allocated risk management costs are not determined until well after the end of the period during which the losses were incurred.		

Answers for Activity 1—Distinguishing Between Prospective Cost Allocation and Retrospective Cost Allocation

Put a checkmark in the appropriate column to indicate whether each statement applies to the prospective type of cost allocation or to the retrospective type of cost allocation.

Questions	Prospective	Retrospective
1. In this type of cost allocation, once the costs are allocated, they do not change and are thus known with certainty.	X	
2. The primary advantage of this type of cost allocation is a stable budget.	X	
3. This type of cost allocation results in delayed allocations that make risk management budgeting becomes more complicated.		X
4. The primary advantage of this type of cost allocation is that costs are more accurately attributed to the period and the department with which they are associated.		X
5. A disadvantage of this type of cost allocation is that increases or decreases in risk control activities are not recognized right away.		X
6. In this type of cost allocation, estimated costs are allocated at the beginning of the accounting period during which they are expected to be incurred.	X	
7. In this type of cost allocation, the primary emphasis is on actual versus potential loss experience.		X
8. A disadvantage of this type of cost allocation is that actual costs can differ substantially from those costs that are actually allocated.	X	
9. A disadvantage of this type of cost allocation is that final allocated risk management costs are not determined until well after the end of the period during which the losses were incurred.		X

Bases for Allocating Hazard Risk Management Costs

Activity 1—Describing Exposure and Experience Bases for Cost Allocation Systems

Each of the following statements is true or false. Indicate whether you think each of the following statements about exposure and experience bases for allocating hazard risk costs is accurate.

Questions	Answers
1. The initial step in the hazard risk management cost allocation process is to determine the types and amounts of an organization's risk management costs.	
2. An exposure-based system is a system that allocates costs to departments on the basis of their loss experience.	
3. Many organizations use a combination of loss exposure and loss experience to allocate costs of hazard risk throughout the organization's departments.	
4. Generally, cost allocation systems for exposures with high claims frequency tend to rely more on loss exposure bases than on loss experience bases.	
5. Managers of larger, more financially capable departments generally want their costs to be allocated by exposures rather than by experience.	
6. The greater the correlation between past losses and future losses, the more closely the loss experience approaches 100 percent credibility.	
7. The same base should be used for determining and allocating all hazard risk management costs to ensure fairness.	
8. If the organization is using <i>experience</i> to allocate costs, then a department that had revenue that was twice the size of	

<p>another department with identical operations should have twice the allocated costs.</p>	
<p>9. If the organization is using <i>exposures</i> to allocate costs, then a department with twice the number of employees of another with identical operations can be considered to have twice the loss exposure and, thus, twice the allocated costs.</p>	
<p>10. When using an exposure-based cost allocation system, the nature of a department's operations also determines the extent of the loss exposure.</p>	
<p>11. The geographic location of the loss exposure should not be used in exposure-based cost allocation systems because location is not a factor that department managers can control.</p>	
<p>12. Because of the U.S. legal system, general liability risk management charges for each dollar of an organization's output in the U.S. should exceed charges for revenues generated in other countries</p>	
<p>13. The exposure bases used by the insurer are usually helpful in determining an appropriate exposure for the type of risk management cost being allocated.</p>	
<p>14. General liability loss exposures are typically consistent across most types of organizations.</p>	
<p>15. The most commonly used exposure basis for allocating automobile liability costs is number of employees.</p>	
<p>16. The two most common exposure bases for allocating workers compensation</p>	

costs are payroll and full-time-equivalent number of employees.	
17. The two most common exposure bases for allocating risk management costs for property are loss experience and revenues.	
18. The effects of location, such as a building located in a hurricane zone, should also be considered when allocating risk management costs for property.	
19. In situations that effectively prohibit using the desired exposure base for a particular type of loss exposure, finding an adequate, practical alternative is generally impossible and costs should be allocated subjectively.	
20. Frequency of losses indicates the quality of most loss control programs better than severity of losses because frequency is usually easier to control than severity.	
21. Average severity, rather than aggregate severity, is the most commonly used indicator of each department's claim experience because it is independent of claim frequency.	
22. When cost of risk allocations are made according to changes in claims paid, rather than aggregates, then the costs to a department tend to fluctuate by accounting period.	
23. Most hazard risk management cost allocation systems are designed to be more sensitive to loss severity than to loss frequency.	
24. The higher the aggregate limit used to set a cap on annual losses, the greater the penalty on a manager with poor	

aggregate loss results.	
25. The longer the experience period, the more responsive the cost allocation formula is to changes in recent past loss experience.	
26. A short experience period tends to subject individual departments to more widely fluctuating charges resulting from unusually good or bad claim experience	

**Answers to Activity 1— Describing Exposure and Experience
Bases for Cost Allocation Systems**

Questions	Answers
1. The initial step in the hazard risk management cost allocation process is to determine the types and amounts of an organization’s risk management costs.	True.
2. An exposure-based system is a system that allocates costs to departments on the basis of their loss experience.	False. Exposure-based systems use exposures while experience-based systems use actual experience.
3. Many organizations use a combination of loss exposure and loss experience to allocate costs of hazard risk throughout the organization’s departments.	True.
4. Generally, cost allocation systems for exposures with high claims frequency tend to rely more on loss exposure bases than on loss experience bases.	False. Higher claims frequency makes loss experience more reliable, and high claims frequency exposures tend to rely on loss experience bases.
5. Managers of larger, more financially capable departments generally want their costs to be allocated by exposures rather than by experience.	False. Managers of these departments would tend to prefer loss experience bases because favorable loss experience can decrease their allocated costs to an amount less than what their department’s size alone suggests.
6. The greater the correlation between past losses and future losses, the more closely the loss experience approaches 100 percent credibility.	True.
7. The same base should be used for determining and allocating all hazard risk management costs to ensure fairness.	False. The base for general liability would likely differ from the base for workers compensation or property damage.
8. If the organization is using <i>experience</i> to allocate costs, then a department that had revenue that was twice the size of another department with identical operations should have twice the	False. When using experience to allocate costs, the actual experience of the departments would determine their allocation.

allocated costs.	
9. If the organization is using <i>exposures</i> to allocate costs, then a department with twice the number of employees of another with identical operations can be considered to have twice the loss exposure and, thus, twice the allocated costs.	True.
10. When using an exposure-based cost allocation system, the nature of a department's operations also determines the extent of the loss exposure.	True.
11. The geographic location of the loss exposure should not be used in exposure-based cost allocation systems because location is not a factor that department managers can control.	False. The geographic location of the loss exposure can be used because it can reflect the difference in benefit levels and expected legal costs to be incurred.
12. Because of the U.S. legal system, general liability risk management charges for each dollar of an organization's output in the U.S. should exceed charges for revenues generated in other countries	True.
13. The exposure bases used by the insurer are usually helpful in determining an appropriate exposure for the type of risk management cost being allocated.	True.
14. General liability loss exposures are typically consistent across most types of organizations.	False. General liability loss exposures vary widely among different types of organizations.
15. The most commonly used exposure basis for allocating automobile liability costs is number of employees.	False. The most commonly used exposure basis for allocating automobile liability costs is the number of vehicles used, with some adjustments for differences in types of vehicles.
16. The two most common exposure bases for allocating workers compensation	True.

costs are payroll and full-time-equivalent number of employees.	
17. The two most common exposure bases for allocating risk management costs for property are loss experience and revenues.	False. The two most common exposure bases for allocating risk management costs for property are square footage and property values
18. The effects of location, such as a building located in a hurricane zone, should also be considered when allocating risk management costs for property.	True.
19. In situations that effectively prohibit using the desired exposure base for a particular type of loss exposure, finding an adequate, practical alternative is generally impossible and costs should be allocated subjectively.	False. Even when the desired exposure base is impossible, practical alternatives are usually available.
20. Frequency of losses indicates the quality of most loss control programs better than severity of losses because frequency is usually easier to control than severity.	True.
21. Average severity, rather than aggregate severity, is the most commonly used indicator of each department's claim experience because it is independent of claim frequency.	False. Aggregate severity (cumulative losses for a given period) is commonly used to indicate each department's claim experience.
22. When cost of risk allocations are made according to changes in claims paid, rather than aggregates, then the costs to a department tend to fluctuate by accounting period.	True.
23. Most hazard risk management cost allocation systems are designed to be more sensitive to loss severity than to loss frequency.	False. Most hazard risk management cost allocation systems are designed to be more sensitive to loss frequency than loss severity.
24. The higher the aggregate limit used to set a cap on annual losses, the greater the penalty on a manager with poor	True.

aggregate loss results.	
25. The longer the experience period, the more responsive the cost allocation formula is to changes in recent past loss experience.	False. The shorter the experience period, the more responsive the cost allocation formula is to changes in recent past loss experience.
26. A short experience period tends to subject individual departments to more widely fluctuating charges resulting from unusually good or bad claim experience	True.

Risk Management Cost Allocation—Practical Considerations

Activity 1—Evaluating a Hazard Risk Management Cost Allocation System

Briefly describe how the proposed hazard risk management cost allocation promotes or fails to promote these desirable features for Richley Stores.

Topics	Answers
1. Does this new system promote greater risk control by the store managers? Why or why not?	
2. Does the proposed system help to facilitate risk retention? Why, or why not?	

<p>3. Does the proposed system improve the store manager's ability to prioritize risk management expenditures? Why, or why not?</p>	
<p>4. Will the proposed system improve cost reductions? Why, or why not?</p>	

<p>5. Will the proposed system distribute costs in a more equitable manner? Why, or why not?</p>	
<p>6. Will the proposed system help managers to better balances risk bearing and risk sharing? Why, or why not?</p>	

<p>7. How does the proposed system improve the access to usable cost information? What design features should be added to make it more useful?</p>	

Answers for Activity 1—Evaluating a Hazard Risk Management Cost Allocation System

Briefly describe how the proposed hazard risk management cost allocation promotes or fails to promote these desirable features for Richley Stores.

Case Study—Richley Stores

Richley Stores operates fifteen home improvement stores in Florida. Each store carries a large selection of general hardware, plumbing supplies, electrical supplies, lumber, and tools.

The Richley corporate culture emphasizes entrepreneurship and accountability at the individual store level. Richley treats its fifteen store managers more like general partners than employees. Managers are compensated based on performance, with one key metric being store profitability.

Richley specializes in retailing to small contractors and homeowners who are attracted by the personal service at each store. Store managers protect the Richley reputation for "going the extra mile" because it gives them a competitive advantage over the large national chains that also operate in their areas. Store managers strongly support one another, think, and act as a team.

For years, Richley Stores has used a relatively simple hazard risk cost allocation system that allocates the bulk of its hazard risk expenses evenly to each store. Richley self-insures much of its workers compensation, property and general liability exposures by purchasing insurance with high deductibles. A captive insurance company funds the retentions.

Richley hired a risk management professional and tasked her to develop an updated hazard loss cost allocation system.

The risk management professional began by reviewing the desired attributes of an effective hazard loss cost allocation system. The primary purpose is allocating potential or actual costs so that the stores are held accountable for loss control. Additionally, those store managers that outperform the others should be rewarded.

She realized that getting the managers to buy into the new cost allocation system was going to be tricky. The store managers at Store 2 and Store 6 were already complaining because their actual experience was better than the rest of the stores. These stores were lobbying for a more retrospective allocation system that focused on performance above all else. The store managers at Stores 3, 4 and 13 were arguing that luck played a greater role in the actual results than management control. The newly appointed manager at Store 13 was particularly angry because she felt that she might be penalized for the actions of the previous manager.

The risk management professional held a facilitated session for the store managers during their quarterly two-day retreat. During the first part of the session, a trained facilitator solicited input from the store managers and let them voice their opinions about what a revised cost allocation system should look like. During the second part of the session, the risk management professional led the discussion and covered specific topics in an effort to get some commitments from the participants.

She explained the pros and cons of prospective versus retrospective systems. The current prospective cost allocation system is too simplistic. A retrospective allocation system is more accurate, but loss costs fluctuate more from year to year and develop slowly.

The risk management professional recommended continuing to use a prospective system. Annual risk audits would supplement the system. The risk audits will use a scoring system to develop debits and credits for the upcoming year. The captive insurance plan personnel will conduct the audits. The cost of the audits will be allocated to overhead and shared evenly.

The risk management professional also recommended overhauling the risk management information system to make it more user-friendly for the store managers. Currently, a summary of losses paid by outside insurance and losses retained within the firm is provided to store managers, but there is only a rudimentary allocation of actual costs to individual stores. Further, the loss costs are not broken down by line of business. The new system would allow the store managers to drill down into the data to look at actual claims to more closely discern the total losses, the portion paid by outside insurance, and the portion paid by the captive.

Under the new system, products liability costs would be retained at the corporate level. Catastrophe loss costs other than insurance premiums would be retained at the corporate level and not be allocated to the stores because the store managers had little control over those costs.

The losses that the managers could control directly would be allocated into three major segments: workers compensation, property, and general liability.

The risk management professional had her own ideas about the appropriate exposure bases to use for these types of loss costs. Still, she wanted to include the store managers in designing the system to achieve greater buy-in. She presented the managers with four different commonly used exposure bases and solicited their input. The exposure bases for each store, along with the trended actual claim costs per store over the past three years, were as follows:

Store #	Revenue	Square footage	Average Inventory Value	Number of Employees	Actual Average Trended Claims Cost Per Store
1	\$23,800,000	100,000	\$3,800,000	127	\$1,725,000
2	\$26,845,000	91,000	\$3,549,000	108	\$1,266,000
3	\$28,896,000	129,000	\$5,289,000	168	\$2,472,000
4	\$29,268,000	108,000	\$4,968,000	137	\$2,115,000
5	\$32,512,000	127,000	\$5,588,000	163	\$2,031,000
6	\$35,052,000	127,000	\$4,953,000	149	\$1,485,000
7	\$26,741,000	121,000	\$5,324,000	150	\$1,965,000
8	\$30,996,000	108,000	\$4,104,000	125	\$1,830,000
9	\$29,250,000	125,000	\$5,000,000	144	\$1,950,000
10	\$29,106,000	99,000	\$4,554,000	120	\$1,575,000
11	\$26,334,000	99,000	\$3,762,000	124	\$1,566,000
12	\$28,527,000	111,000	\$4,995,000	150	\$1,815,000
13	\$29,792,000	133,000	\$5,320,000	162	\$2,220,000
14	\$23,490,000	87,000	\$3,828,000	104	\$1,500,000
15	\$28,730,000	130,000	\$4,940,000	156	\$1,830,000
Total	\$429,339,000	1,695,000	\$69,974,000	2,087	\$27,345,000

She then summarized the potential allocation systems and the results of using each of the bases as a comparison to the existing system.

Store #	Actual Average Trended Claims Cost Per Store	Current Allocation System	Allocation			
			Allocation Based on Revenue	Allocation Based on Square Footage	Allocation Based on Inventory	Allocation Based on Employees
1	\$1,725	\$1,695	\$1,515	\$1,614	\$1,485	\$1,665
2	\$1,266	\$1,659	\$1,710	\$1,467	\$1,386	\$1,416
3	\$2,472	\$1,935	\$1,839	\$2,082	\$2,067	\$2,202
4	\$2,115	\$1,830	\$1,863	\$1,743	\$1,941	\$1,794
5	\$2,031	\$1,968	\$2,070	\$2,049	\$2,184	\$2,136
6	\$1,485	\$1,932	\$2,235	\$2,049	\$1,935	\$1,953
7	\$1,965	\$1,875	\$1,704	\$1,953	\$2,082	\$1,962
8	\$1,830	\$1,782	\$1,974	\$1,743	\$1,605	\$1,638
9	\$1,950	\$1,878	\$1,863	\$2,016	\$1,953	\$1,887
10	\$1,575	\$1,761	\$1,854	\$1,596	\$1,779	\$1,572

11	\$1,566	\$1,707	\$1,677	\$1,596	\$1,470	\$1,626
12	\$1,815	\$1,851	\$1,818	\$1,791	\$1,953	\$1,965
13	\$2,220	\$1,941	\$1,896	\$2,145	\$2,079	\$2,124
14	\$1,500	\$1,632	\$1,497	\$1,404	\$1,497	\$1,362
15	\$1,830	\$1,899	\$1,830	\$2,097	\$1,929	\$2,043
Total	\$27,345	\$27,345	\$27,345	\$27,345	\$27,345	\$27,345

* All numbers in thousands of dollars

The manager of Store 2 quickly pointed out that the actual loss costs were nearly \$450,000 lower than the allocated costs under any of the allocation systems. The risk management professional reminded the participants that the risk audits would address the fairness issue to some extent, but that there was going to be a tradeoff between accuracy and timeliness.

During the ensuing discussion, the store managers agreed in principal that certain types of costs should be allocated to stores and certain types should be handled as overhead and allocated evenly. Catastrophe loss insurance premiums for each store and safety training team visits, for example, should be allocated directly to each store. On the other hand, the bulk of the safety training team's own internal training and management costs provided an indirect benefit to each of the stores that should be shared equally. Similarly, costs to upgrade and modernize the risk management information system should be allocated evenly across stores because all managers would benefit equally.

The store managers agreed that inventory value would be an appropriate base for the property loss costs. They also agreed that the monthly values would better reflect the true value at risk.

The managers were divided over workers compensation costs because the mix of workers at the stores differed. Some stores relied more heavily on part-time workers while others had a greater proportion of professional sales staff and building consultants that helped drive sales.

The store managers disagreed over using square footage or revenue as the base for general liability loss costs. The risk management professional said she would develop a hybrid system that incorporated both bases. She promised to distribute some numbers to the store managers in the coming weeks.

The risk management professional then informed the store managers that the new allocation system would be in place by the end of the fiscal year. She thanked them for their input and reminded them that the system was dynamic. Although the managers agreed on the general concept, the system could change as the managers grew more familiar with it over time.

Questions	Answers
1. Does this new system promote greater risk control by the store managers?	The new system does a better job of allocating costs, but prospective systems trade off accuracy for predictability. Additionally, there is some degree of randomness in actual loss costs. If the new system more accurately allocates costs, managers will have greater incentives to control losses.
2. Does the proposed system help to facilitate risk retention?	Having more information will allow the managers to do a better job of managing risk, thus increasing the potential for retention.
3. Does the proposed system improve the store manager's ability to prioritize risk management expenditures?	The audit system will produce immediate incentives to control loss costs. However, it will take time to evaluate their effectiveness.
4. Does the proposed system improve cost reductions?	Greater risk control should reduce overall loss costs and optimize risk-taking.
5. Does the proposed system distribute costs in a more equitable manner?	No system is perfect, but this system will be an improvement because the store managers helped to design it.
6. Does the proposed system help managers to balance risk bearing and risk sharing?	<p>The greater correlation between risk control and expense reduction, which will feed directly to the store managers' bottom lines, should help to balance risk bearing and risk sharing.</p> <p>The new system also focuses more on manageable risks and less on unavoidable risks.</p>
7. What type of additional information does the proposed system provide, and how can it be improved to provide more usable cost information?	The detail on the components of loss costs will allow the managers to better assess the types of risk that they are absorbing and will give them better insight into risk control efforts.

	<p>There is a tradeoff between having too much information, which may create confusion, and having too little.</p>
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