

# Business Interruption: Codebreaker/Calculating Business Interruption

Presented to: Midwest Higher Education Compact (MHEC)

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# Agenda

- What is Business Interruption?
  - MHEC Policy Definition
  - Business Interruption Value and Risk
- Insurance Carrier and MHEC Expectations
- Business Interruption Approach
  - Example 1: Income Statement to Gross Earnings BI worksheet
  - Ordinary Payroll – Key Term
  - Example 2: The IPEDS Worksheet
- Differences Between Values and Loss
- Special Considerations After a Loss
  - Research
  - Extra Expense

# What is Business Interruption?

## MHEC Policy Definition: SECTION IV - TIME ELEMENT

“The Company will pay for the actual Time Element loss the Insured sustains, as provided in the Time Element Coverages, during the Period of Liability. The Time Element loss must result from the necessary Suspension of the Insured's business activities at an Insured Location. The Suspension must be due to direct physical loss of or damage to Property (of the type insurable under this Policy other than Finished Stock) caused by a Covered Cause of Loss at the Location, or as provided in Off Premises Storage for Property Under Construction Coverages.

The Company will also pay for the actual Time Element loss sustained by the Insured, during the Period of Liability at other Insured Locations. The Time Element loss must result from the necessary Suspension of the Insured's business activities at the other Insured Locations. Such other Location must depend on the continuation of business activities at the Location that sustained direct physical loss or damage caused by a Covered Cause of Loss.”

Note: Please see the policy for the full definition.

# What is Business Interruption?

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# Business Interruption Values and Risk

- Business Interruption Values:
  - Are used to determine the appropriate amount of insurance coverage for Business Interruption (BI) and Extra Expense (EE)
  - Carriers use the BI value to calculate adequate premiums
  - Are able to provide a “watermark” for use in upcoming years
  - Enable members to respond quickly and professionally to underwriting requirements in today’s restrictive environment
- Business Interruption Risk relates to loss of earnings due to physical damage of covered property
  - May include service interruption
  - Revenue losses may be mitigated by using alternative locations and incurrance of extra expenses
  - Service operations losses may incur extra expense if alternate operations can not be established (fire suppression, power supply, etc.)

# Insurance Carrier and MHEC Expectations

- Insurance Carriers expect you to forecast your business interruption exposure for the upcoming program renewal. They expect:
  - **Annual** Revenues Less Expected Annual Cost of Revenues
  - For 1 Year (12 month) **Prospective** Period
- Business Interruption worksheets are a relatively standard form that insurance carriers accept. We have tailored this to Higher Education to make the process as painless as possible
- Types of Business Interruption Worksheet:
  - Gross Earnings BI Worksheet (MHEC Preferred)
  - The Integrated Postsecondary Education Data System (IPEDS) Worksheet. (MHEC Preferred)
  - Operating Income BI Worksheet

# Insurance Carrier and MHEC Expectations

- Values need to be reviewed annually and whenever there is a material change in business operations
  - Material change includes:
    - Addition/reduction of student population
    - New university programs and services
    - Trends in industry (changes in tuition and government funding)
    - Increased cost of operations (instruction costs, maintenance, etc.)

# Business Interruption Approach

BI indemnifies an insured for the operating income lost and the necessary continuing costs and expenses incurred over the period that the business is being restored.

Top-Down Approach	Bottom-Up Approach
Revenue Less Expenses	Operating Income Plus Fixed Expenses
Revenue	Operating Income
—	+
Direct Materials	Fixed General & Admin. Expense
Variable Supplies and Utilities	Depreciation & Amortization
Ordinary Payroll*	Rent & Equipment Leases
Variable Operating Expenses	Insured Payroll
Bad Debt Expenses	Fixed Contract Commitments
=	=
Business Interruption Value	Business Interruption Value

\* Subject to the Days of Ordinary Payroll Coverage Selected

Both approaches to calculating BI values will yield the same results.



# Example 1: Income Statement to Gross Earnings BI worksheet

## Income Statement

	2019	2020	2021
<b>Operating revenues:</b>			
Student tuition and fees	\$148,142	\$149,550	\$146,714
Auxiliary enterprises	74,147	70,541	71,087
Grants and contracts	15,862	17,672	16,397
Sales and service	3,490	3,776	3,161
Other operating revenues	3,824	4,147	3,630
Total operating revenues	245,465	245,686	240,989
<b>Operating expenses:</b>			
Educational and general	208,516	210,188	207,252
Scholarships and fellowships	19,141	18,387	18,001
Auxiliary enterprises	74,715	68,216	69,520
Operations of maintenance of plant	20,106	20,763	20,480
Depreciation and amortization	25,308	25,923	26,267
Other expenses	4,436	6,865	6,316
Total operating expenses	352,222	350,342	347,836
Operating loss	(106,757)	(104,656)	(106,847)
<b>Non-operating revenues:</b>			
State appropriations	71,545	69,025	67,233
Other non-operating revenues	37,642	46,635	23,204
Total non-operating revenues	109,187	115,660	90,437
(Loss) Income before other changes	2,430	11,004	(16,410)
Capital appropriations, grants and gifts	9,267	8,663	13,377
<b>Change in net position</b>	<b>\$11,697</b>	<b>\$19,667</b>	<b>(\$3,033)</b>

## Gross Earnings BI Worksheet

		Actual Value for the Fiscal Year Ending 2020	Estimated Value for the Fiscal Year ending 2021
A.	TUITION and FEES	\$149,550	\$146,714
B.	OTHER INCOME (Where Applicable)		
C.	TOTAL OTHER INCOME	\$211,796	\$184,712
D.	TOTAL REVENUE (Line A. + Line C.)	\$ 361,346	\$ 331,426
E.	DEDUCTIONS (All Expenses that would Discontinue if the Institution Shutdown Operations - Variable Expenses) (1)		
	1. Education and General	\$ 52,547	\$ 51,813
	2. Scholarships and Fellowships	\$ 18,387	\$ 18,001
	3. Auxiliary Enterprises	\$ 17,054	\$ 17,380
	4. Operations of maintenance of plant	\$ 5,191	\$ 5,120
	5. Other Expenses	\$ 1,716	\$ 1,579
F.	TOTAL DEDUCTIONS	\$ 94,895	\$ 93,893
G.	INSURABLE INCOME (Line D. - Line F.)	\$ 266,451	\$ 237,533

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# Ordinary Payroll – Key Term

- What is Ordinary Payroll?
  - Payroll for non-exempt employees, which the policyholder is choosing to insure.
- Which employees should be considered?
  - All employees should be considered except for:
    - Officers/executives (exempt employees).
    - Department managers.
    - Employees under contract.
    - “Key” employees or employees with special skills.
- Add benefits, FICA, dues, and WC premium to wages.
- Ordinary Payroll can apply for any number of days ranging from 0 (no coverage) to 365 days (full coverage); however, it is typically applied in 30-day increments.
- Specific groups of employees, which are subject to Ordinary Payroll, may be insured for a different number of days (e.g., clerical staff for 90 days and maintenance staff 180 days).

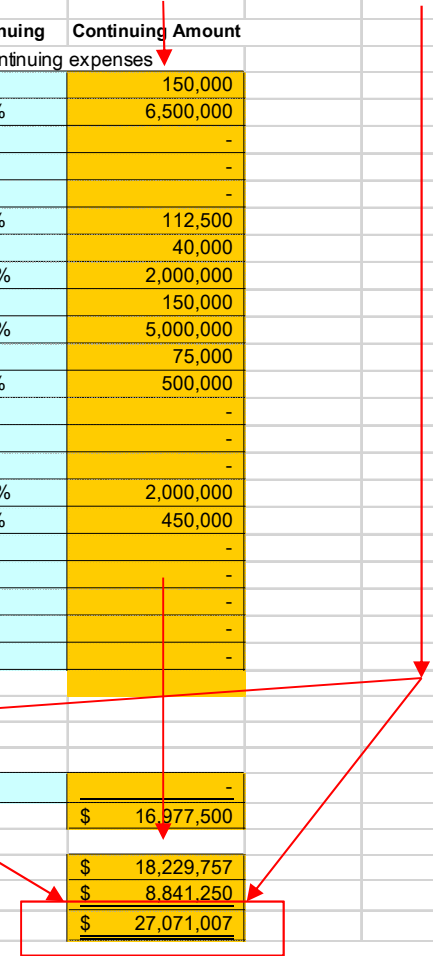
# Example 2: The Integrated Postsecondary Education Data System (IPEDS) Worksheet.

Part	Line # / (col)								
<b>Fixed and continuing expenses / items</b>									
C	19/6	Interest - debt service relating to academic and administrative buildings						1,252,257	
C		Other fixed nonoperating expenses and deductions (formerly 17/1)						-	
C	19/5	Depreciation						-	
		This line for additional costs at the institution's discretion						-	
		Total fixed and continuing expenses/items above						\$ 1,252,257	
<b>Operating Expenses - allocations to continuing and non-continuing categories:</b>					<b>Total Amount</b>	<b>% Continuing</b>	<b>Continuing Amount</b>		
<b>Part</b>	<b>Line # / (col)</b>	<b>Education and general: Separate line items into Materials, supplies etc. and Salaries and Wages prior to allocations to continuing expenses</b>							
C	01 / 7	Instruction -	Materials, supplies etc.		3,000,000	5%	150,000		
C	01 / 2		Salaries and wages		13,000,000	50%	6,500,000		6,500,000
C	02 / 7	Research -	Materials, supplies etc.		-		-		
C	02 / 2		Salaries and wages		-		-		-
C	03 / 7	Public Service -	Materials, supplies etc.		20,196		-		
C	03 / 2		Salaries and wages		150,000	75%	112,500		37,500
C	05 / 7	Academic support -	Materials, supplies etc.		800,000	5%	40,000		
C	05 / 2		Salaries and wages		2,000,000	100%	2,000,000		-
C	06 / 7	Student services -	Materials, supplies etc.		3,000,000	5%	150,000		
C	06 / 2		Salaries and wages		5,000,000	100%	5,000,000		-
C	07 / 7	Institutional support -	Materials, supplies etc.		1,500,000	5%	75,000		
C	07 / 2		Salaries and wages		2,000,000	25%	500,000		1,500,000
C	10 / 1	Scholarships and Fellowships	Expenses		8,000,000		-		
C	10 / 2		Salaries and wages		-		-		-
C	11 / 7	Auxiliary enterprises -	Materials, supplies etc.		5,000,000		-		
C	11 / 2		Salaries and wages		2,000,000	100%	2,000,000		-
C	08 / 7	O&M of physical plant (Facilities) -	Materials, supplies etc.		3,000,000	15%	450,000		
C	08 / 2		Salaries and wages		-		-		-
C	12 / 7	Hospital services -	Materials, supplies etc.		-		-		
C	12 / 2		Salaries and wages		-		-		-
C	13 / 7	Independent operations -	Materials, supplies etc.		-		-		
C	13 / 2		Salaries and wages		-		-		-
									8,037,500
C	19 / 2	Total Salaries and Wages*		10					
C	19 / 3	Total fringe benefits*		1	10%				
Note 3		Utilities expense			0		-		
		Total continuing expense portion of operating expenses					\$ 16,977,500		
		<b>Total Business Income Value</b>					\$ 18,229,757		
		<b>Insured Ordinary Payroll Value (see note below)</b>					\$ 8,841,250		
		<b>Total Time Element Value</b>					\$ 27,071,007		

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**% Continuing  
Varies by Institution**



# Differences Between Values and Loss

- **Values:** The calculation of values occurs at the beginning of the policy period
  - Reporting:
    - A Single BI worksheet, allocated over all or select locations
    - Multiple BI Worksheets, often for each revenue producing location
  - Values consider revenues **less** direct variable cost
- **Losses:** The calculation of the loss occurs at the time of loss
  - Losses consider revenues **less** direct variable cost **less** non-continuing expenses
  - Losses typically consider the impact on the *entire* campus



# Research - Consideration

- Impact on Research Projects
  - Lost Data
  - Lost Materials
  - Project Delays
    - Temporary
    - Funding Issues
    - Available Replacement / Recreation of Data
    - Timing of Equipment Replacement
    - Graduate Program Delays
  - Permanent
    - Inability to Recreate
- Loss of Future Research Projects Tied to Affected Lost Research / Samples

# Extra Expense - Consideration

- Analyze to determine eligibility for insurance claim
  - Depends upon type and/or purpose of expense
  - Examples of extra expenses
    - Temporary classrooms
    - Rental of trailer and related set-up and ongoing operating costs
    - Hotels/temporary living
    - Food services
    - Daily living expenses
    - Cell phones/calling cards
    - Transportation
    - Security
    - Postage and mailings
    - Labor costs
    - Extended school year
- College/university will most likely incur costs to maintain classes versus losing students
- Gather supporting documentation for expenses



# Thank You

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