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AGB

Board
Essentials
Series

The Board's Role in Financial Oversight

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Introduction

An often-volatile economy, changing demographics, and technological innovations in educational delivery are among the dramatic changes across higher education that have forced boards and institutions to question the viability of the existing business model. Flat or declining state support in real terms, lower investment returns in some years, shifts in federal support, and pressure to control tuition costs have forced institutions to find more efficient and effective ways to operate without compromising quality. Understanding the financial context in which colleges and universities operate is critical to a board's ability to carry out its fiduciary responsibilities.

Historically, higher education boards have focused almost exclusively on the annual operating budget and the budget process. However, specific events over the past decade have reinforced the need for board members to more fully understand the ways in which the institution's sources of financial support are changing over time and the shifts in the multiyear capital requirements for such items as deferred maintenance and debt-service. For example:

- The dramatic downturn in the economy in 2008–09 and the ensuing global recession clarified the need for boards to understand the institution's investment portfolio and the liquidity required to meet operating expenses, including debt-service requirements.
- Growing deferred maintenance of facilities, the need for renewal and adaptation of existing facilities, and pressures for new facilities to meet growing enrollments or more technologically based 21st-century teaching and research have required boards to better understand the institution's capacity for debt financing.
- As institutions experienced unexpected withholding of state support, shifts in federal aid, and the devastation that can result from natural disasters such as hurricanes, floods, and tornadoes, boards realized the need to pay more attention to the level of unrestricted financial resources.
- The impact of the volatile financial markets on defined-benefit pension plans has forced boards to look at the impact of pension liabilities on future operating expenses and the viability of such plans going forward.
- The lack of growth in state and federal support, variation in expected long-term returns on endowment investments, and the emphasis on student access and affordability have underscored the need to understand whether the institution's business model is sustainable in the long term.

Against the backdrop of such pressures, in 2013, financial analysts at Moody's Investors Service issued their first-ever negative outlook for the entire nonprofit (public and independent) higher education

BOARD ESSENTIALS

SECTION 1

Overview of the Full Board's Role in Financial Oversight

Good Stewardship

The financial, physical, and human resources of the institution are entrusted to the board's care. As good stewards, board members must ensure that the resources are protected and used effectively, efficiently, and strategically to carry out the mission of the institution—both today and in the future. To do this, appropriate policies, procedures, and practices must be in place. The board often delegates responsibility to a finance committee (working with other committees) to ensure that resources are secured, allocated appropriately among short-term and long-term needs, and adequately maintained and renewed. It is the finance committee that provides financial guidance to the full board on sustaining the institution financially, protecting its assets, and determining what is possible with the available resources.

Protecting Institutional Resources

In exercising the responsibility for protecting the institution's financial resources, the board needs evidence that the appropriate controls are in place to mitigate misuse and misappropriation of assets. In addition to internal accounting controls, the institution must have investment and debt policies that reflect the risk tolerance of the board and its goals for growing and leveraging assets. Historically, this function has often been performed by a board audit committee; today, a growing number of institutions are taking a broader approach to risk management (discussed more fully below), of which audit is one important element.

The board must also provide oversight of the institution's human resources. After the student body, the most precious asset of the institution is the faculty, staff, and administration. The institution's ability to recruit, retain, and reward its employees plays a critical role in the institution's quality, competitiveness, and culture. To exercise appropriate oversight, the board must understand how salary and benefits compare to those at similar institutions and support closing the gap where required. Given the growing emphasis on accountability, the board must also be aware of the processes in place that support performance management and ensure that rewards are based on merit, are viewed as fair, and that employee morale is good. To this end, the board should know how the institution is investing in maintaining and growing the professional competence and skills of its academic, administrative, and support staffs. Given that an institution's employees compose a critical asset and are the largest single expense, many boards have established a separate compensation committee. A board compensation committee deals not only with the compensation contract of the president or chancellor and the annual performance review, but also provides oversight for the compensation policies and workforce management of all employees. Where a compensation committee exists, it must work closely with the finance committee to ensure that resource commitments related to compensation are consistent