RISK MANAGEMENT

An Accountability Guide for University and College Boards

Second Edition

Janice M. Abraham
with Sarah Braughler, Liza Kabanova, and Justin Kollinger

AGB ASSOCIATION OF GOVERNING BOARDS OF UNIVERSITIES AND COLLEGES

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Preface—Second Edition

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Is there a need for a second edition of *Risk Management: An Accountability Guide for University and College Boards*? Have higher education and the world in general changed enough to merit a fresh look at the role governing boards and senior leadership should play in risk management?

A view of the landscape since 2013 yields an emphatic Yes. The economic, social, and political landscape has shifted dramatically in the intervening years, adding increased volatility, greater media and public scrutiny, and Generation Alpha getting ready to arrive at our campuses. "Is the business model of higher education sustainable?" is the most frequent question governing board members ask as we travel throughout the country. The answer, we believe, is no—not in its current structure. No, because the math doesn't work, there won't be enough high school graduates to spread around the country to fill the seats vacated by Millennials, and the public (families and legislators) isn't willing to pay the money required to support the traditional higher education experience (four or five years of college after high school and perhaps followed by a graduate degree).

What changed? COVID-19 pandemic, demographic change, technology finally offering quality learning opportunities, scandals that knocked colleges from the pedestal, an ever-expanding social economic divide, shifting needs of employers, global competition, and higher education's reluctance to take these external risks and opportunities seriously and adapt when it still had the luxury of time.

Is this an existential threat for all of higher education? Another emphatic no. But the reality is stark, and higher education must adapt to survive. We believe that boards and campus leaders that take the principles of risk management seriously have a better chance of thriving in this tumultuous environment. While research on the return on investing in enterprise risk management (ERM) for higher education has not been completed, more research is quantifying returns in the corporate sector.

> "The results suggest that an ERM framework and an ERM implementation can help companies improve performance by enabling executives to manage the company better. From a practical standpoint, companies ask how ERM adds value. Our results show that value comes from implementing the process, which then enables the company to make better decisions."
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> —Paul L. Walker, James J. Schiro / Zurich Chair in Enterprise Risk Management Executive Director, Center for Excellence in ERM, St. John's University Tobin College of Business

As more higher education institutions embrace (or consider embracing) ERM, I am pleased that this second edition of the *Accountability Guide* continues to evolve in order to remain relevant and useful to governing boards. Part I of the guide now has a chapter on ERM program maturity, and Part II includes new discussions on compliance and reputational risk—areas where boards are increasingly shifting their focus. In addition, the risks discussed in Part II are reorganized to reflect a growing practice to establish board committees focused on the broad goals of the board rather than the functional areas of the institution. While we maintain our commitment to a "noses in and fingers out" approach to board governance, the increasingly precarious environment for colleges and universities create a call for boards to encourage and engage in a robust and comprehensive ERM program at the institutions they serve.

Janice M. Abraham

PART I

Fundamentals of Risk Management

"The word 'risk' derives from the early Italian *risicare* which means 'to dare.' In this sense, risk is a choice rather than a fate!"

—Peter L. Bernstein, author of *Against the Gods: The Remarkable Story of Risk*

Chapter 1

Good Risk Management is Good Governance

"In the future, we will look at risks affecting the whole of an organization and its place in the community. We will address both upside and downside consequences, and our view will be enterprisewide, integrated and holistic. The result will be a more intelligent balance between potential benefits and harms. We will increase the confidence of stakeholders in our organizations and make them more resilient in a day and age of increased uncertainty. This is the real goal of risk management."

—H. Felix Kloman, editor and publisher, *Risk Management Reports*

The Future Is Here

AT ITS CORE, RISK MANAGEMENT IS A governance and management discipline—not an end but a means to the end, the end being the accomplishment of the institution's mission. What is risk management from the board's perspective? Just as good financial management is more than a clean audit opinion, good risk management is more than not getting sued and having adequate insurance policies in place. Effective risk management prepares an institution to weather literal and figurative storms and sets the course for accomplishing the institution's strategic plan.

Whether you have just been appointed to a board position or have long served as a board member for a college or university, you no doubt recognize the increasing responsibilities being placed on boards for better institutional oversight.

When things go wrong, the board should have known that all was not well. Even if the wrongdoing falls beyond the scope of traditional board responsibility, finger-pointing by the media, alumni, parents, students, and others now means that every board must have a thorough understanding of the risks at its institution and up-to-date knowledge of how well the administration is working to mitigate those risks.

Historically, colleges and universities have had a strong track record of successfully weathering catastrophic events, which speaks to their resilience and historic place in society. But while the past decade has been difficult for many institutions, today's environment is different. Public perception of higher education, once universally seen as a public good, has declined as tuition and student debt have grown, each new scandal or controversy inflicting further harm. The rapid pace of change and innovation, the 24/7 news cycle and insatiable appetite for information, the litigation climate, and increasing scrutiny by politicians and regulators all place more pressure on boards to get it right.

In this climate, boards must set the tone for the importance of risk management. Once it seemed unlikely that a single long-term trend or catastrophic event could close an institution, but as increasing numbers of colleges run out of resources and face closure, unmanaged risk is now an existential threat to many. The margin of error is significantly narrower as weak finances and increased competition for a shrinking pool of students become more common.

Benign neglect or poor preparation for major risks can weaken and undermine an institution, leaving it with a diminished reputation, an inability to respond, and plans once embraced by the community unfulfilled. Boards are most effective if they operate with a clear set of priorities and concentrate on strategic oversight. Risk management should be on every board's to-do list for oversight.

The Role of Risk Management

With myriad demands resting on the shoulders of boards and senior administrators, it is reasonable to ask: Why invoke risk management as yet another process in a process-laden structure? Will it really make a difference in how the institution plans or functions?

While no one can effectively calculate the total cost of risk, consider these costs of failing to prepare for events that history proves are inevitable:

- *What were the opportunity costs* as the board and senior leadership huddled in meetings to chart a recovery after a significant risk was realized?

- *How much money was spent*, excluding insurance or outside sources, to try to speed the recovery?
- *What was the loss of promising faculty* who decided to accept competing offers?
- *How many people made decisions to enroll elsewhere* who might have become future alumni?
- *Which donors held back on major gifts* until the institution could sort things out—or didn't give at all?
- *How did rating agencies respond?* Was a bond rating lowered, or not raised, in turn raising questions about the financial strength of the institution?
- *How much additional effort must now be expended to instill future confidence* in the institution?[1]

An effective institutional or enterprise risk management (ERM) program, which has the full support and engagement of the governing board, will increase the likelihood that a college, university, or system will achieve its plans, increase transparency, and enable better allocation of scarce resources. Good risk management is good governance.

Evolution of Risk Management

The field of risk management is evolving. The transformation began in the late 20th century, when the focus was risk transfer and loss control, and an institution's exposure to losses drove the thinking about risk management. Where could the institution suffer a loss, usually defined by a lawsuit, fire, flood, or accident? How could the institution reduce its exposure? Addressing these questions meant buying insurance and signing contracts with service providers to transfer risks. Campus loss control focused on safety, physical injury from slips and falls, and property damage from natural disasters.

ERM in Higher Education

Enterprise Risk Management took hold in the corporate world in the early years of the 21st century. Models developed by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission and the International Standards Organization (ISO) established the framework