Grant Thornton

The State of Higher Education in 2017

Sixth annual report

Article excerpt:
Moving Beyond ERM Theory to Real-World Implementation

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Introduction

Leaders of colleges and universities have new opportunities, technologies and analytical tools to help them drive their institutions toward greater success. They are mining new revenue sources, gaining access to more in-depth information for improved decision-making, initiating transformative endeavors in academic and administrative areas, and applying advanced techniques to assess institutional and student performance.

Leaders are likewise dealing with such issues as challenges in tuition and enrollment, making effective use of physical assets, competition from both traditional and nontraditional education providers, changes in regulatory requirements, and imperatives to mitigate or at least be prepared to respond to institutional risks.

This is a time of great potential for engaging a diverse constituency, collaborating with other institutions and private industry, and effecting substantial operational change. Innovative thinking will be vital to successfully moving into the future.

In this, our sixth annual *State of Higher Education* report, we offer you our experience-based viewpoints, approaches and solutions that point the way to decision-making that will sustain institutions, positioning them to thrive for the long term. While we will continue throughout the course of this year to provide webcasts, training and articles of interest to leaders in higher education, the editorial purpose of this publication is to cover the trends and issues we expect to emerge in 2017. As a leader in the higher education sector, we believe it is our responsibility to give back to this community we serve by providing these valuable insights.

Within these pages, you will find our guidance on important developments and challenges facing higher education leadership, including redefining business models, practical implementation of enterprise risk management, changing federal regulations regarding endowments and accessibility, campus physical space transformation and funding of deferred maintenance, increased use of data analytics, and many others.

The articles in this report stem from knowledge gained through our professionals' direct interactions with their clients. Rather than theoretical pieces, they are the result of practical, hands-on experience gained by more than 400 Grant Thornton LLP professionals serving over 200 eminent higher education clients. These insights are intended to be used by you — board members, executives, management, and other leaders and stakeholders in higher education.

Our Not-for-Profit and Higher Education practices are committed to helping "organizations that do good" fulfill their missions. We understand that enhancing quality, protecting reputation and maintaining operational sustainability are all essential to colleges' and universities' ability to achieve success and further their cause. Our higher education experience is deep, and we offer it to assist higher education leadership with the challenges and opportunities addressed in this report.

On behalf of the partners and professionals of Grant Thornton's Not-for-Profit and Higher Education practices, I am pleased to present *The State of Higher Education in 2017*. We hope that you find this to be a valuable resource. As always, we welcome your feedback and are available to assist management teams and boards in addressing the challenges discussed in this report, or any other issues you may be facing.

Sincerely,

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Watch Mark's introduction to the report.

Moving Beyond ERM Theory to Real-World Implementation

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For as much as colleges and universities have a healthy respect for risk and a desire to implement leading-edge enterprise risk management (ERM) programs, many still struggle with translating the theory they find in literature into a practical and effective program. There is no single correct way to implement ERM, which leaves institutions to their own devices in interpreting ERM concepts as they attempt to adopt risk management protocols. This often leads to suboptimal efforts that fall short of achieving their objectives — or worse, to abandonment of ERM initiatives altogether.

However, effective implementation of ERM can indeed be achieved, and the common pitfalls that institutions face when designing an ERM program from scratch can be overcome. Success comes from utilizing a comprehensive, structured methodology, informed by the experience of others, to identify, evaluate, report and mitigate key risks to your institution. We offer these best-practices strategies — from institutions that have recently successfully deployed ERM or those that are currently in the midst of successful implementation — to overcome the challenges you will face and to translate theory into meaningful, practical action.

Recognize that risks do not all have the same impact

Even the most introductory primer on ERM will tell you that you have to evaluate the impact of a risk. Put simply, risk impact is the degree to which you will be affected by a risk if it were to happen. However, not all risks will affect an institution in the same way. While senior leaders are typically adept at identifying their institution's top risks, they often perceive the impact of each risk, and what therefore constitutes an appropriate response, quite differently.

> **Example:** A CFO might not perceive there to be a significant impact associated with inaccurate collection/reporting of admissions data as it would not cause an appreciable change in revenue or expense. The vice president of communications, on the other hand, would be highly attuned to the consequences of negative press associated with such an incident.

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The key is to recognize that impact has many different facets. In order to align discussions around why risks are significant and what should be done about them, we advocate dividing your analysis into types of impact:

- Strategic — Causes a strategic objective to fail
- Financial — Incurs unanticipated costs or reduces revenues
- Operational — Affects the quality or efficiency of how work gets done
- Reputational — Creates negative media attention
- Environmental, health and safety — Jeopardizes students', faculty's or others' well-being
- Technology — Exposes applications, data, operating systems, network, or infrastructure to inappropriate access/change
- Legal — Triggers arbitration or litigation against your institution

When evaluating risks, you should consider the resulting impact. One risk may have a high financial and technology impact, while another may be more reputational in nature. At times, one or more of the impact types won't apply at all. While these are typical impact categories, management may decide that other types of impact apply.

Calibrate your discussion

Begin by creating guidelines for your risk evaluation framework. Whether you use a simple high/medium/low scale or a more complex numeric rating, document what qualitatively differentiates one risk rating from another. While business judgment is still an integral part of evaluating risk, setting parameters helps level the discussion and resolve differences of opinion by applying objective criteria.

> **Example:** The chief compliance officer is concerned about the risk of failing to comply with a regulation. She argues that it has a high impact on reputation and finances. Her research shows that when fines are imposed, they are usually between $25,000 and $50,000. The ERM committee refers to their calibrated risk evaluation framework and sees that they have previously determined that in terms of reputation, a risk would have to be noted on a national scale and/or cause their constituents to distance themselves from the university in order for it to be considered to have a high reputational risk — an unlikely result in this case. They also note that a risk would have to deplete their reserves by $200,000 or more before they would consider it a high risk. Since there are no other discernible types of impact that would apply, they decide that the risk of this lapse in compliance would have, at most, a medium impact on the university.

Align your mitigation strategies

Successful ERM programs strive to ensure that the institution's risk management activities directly address the types of impacts expected.

> **Example:** A particular risk event may have significant financial, reputational and operational impacts. A comprehensive risk mitigation strategy should address all three areas. Financial impact mitigation may involve obtaining insurance, creating a reserve fund, etc. Reputational impact mitigation may include developing clear communication and media relations plans. Operational impact may be mitigated through creation or revision of disaster recovery and business continuity plans. Other risk management strategies may, of course, apply.

One of the common mistakes institutions make is ending the discussion after identifying a single mitigation strategy. This limits identification of additional mitigation strategies that can further reduce risk impact by addressing other potential outcomes of a risk event.

Establish your risk tolerance

Risk tolerance, or risk appetite, is the willingness to accept uncertain outcomes. In an attempt to define their risk tolerance, to avoid either taking on too much risk or being unnecessarily cautious, we have found that institutions tend to create broad statements about their attitude toward risk.

While there seems to be very little written about how to define risk tolerance, the practical experience of institutions that are in the process of doing this effectively is that such definitions need to be less broad and more nuanced. It is not helpful to declare, “We are risk avoiders,” or “We are risk takers.”

To get started, we advocate establishing a risk tolerance scale. For example:

- Averse — Low tolerance for uncertainty; prefer the lowest risk option
- Cautious — Prefer to avoid risks but will accept some uncertainty if benefits are significant
- Accepting — Uncertainty is expected; prefer the option that maximizes benefits

There is no single risk posture for an institution to take. Rather, tolerance for risk will vary, depending on the nature of its impact. You can then establish your institutional risk tolerance along each of the types of impact. For example, you may be:

- Cautious about strategic risks
- Accepting of financial risks
- Averse to reputational risks
- Averse to health and safety risks

Assessment of tolerance serves as an important lens to determine if enough is being done when considering risk mitigation strategies. Aligning risk mitigation strategy with risk tolerance can be further informed by gleaning lessons learned when risk events actually happen. You can answer questions like, “Did we accept more risk than we wanted?” and “Were we too conservative in our reaction to risk?” These answers will help you to continually shape and refine your ERM program.