



**QUESTIONS FOR EXCELLENCE:
A BOARD GUIDE TO COLLEGE AND UNIVERSITY PLANS
Essay 7**

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Asking About Risk Management

The college or university's risk exposure is a trustee's risk exposure. Trustees are responsible for protecting the financial assets of the institution, for the safety of the campus community and for the college or university's educational promises. The risk exposure of the college or university must be within the risk tolerance of the board. There can be no compromise between a risk-taking administration and a conservative, risk-averse board. The ultimate responsibility of the board for the college makes it mandatory that the administration take no chances that the board would not stomach. The challenge is not avoiding mismanagement, but avoiding miscommunication. A board will not appear to be taking its responsibilities seriously if it avoids correcting a college's exposure to risk when the risk moves outside of its tolerance levels. Trustee wisdom and vigilance are lost if the board's risk judgments are not well conveyed.

Many of the considerations raised in this chapter have financial implications and have historically been handled by finance committees. Whichever board group examines the area, an attempt should be made to look at the full range of risk-related issues. The possibility of one bad outcome is not balanced by the possibility of a less dangerous outcome in another area. Risk is additive. Thus, while the subject of risk exposure is seldom discussed in a unified manner by boards, this chapter sets out its questions as though risk were a regular topic. Risk is usually a hidden issue within many other types of discussions. Whenever the administration presents a plan or policy, it is implicitly asking, among other questions, "Are you, the board, comfortable with this? Do you think the college should take this risk?" Board uneasiness with proposed risks should motivate an administration to search for risk-mitigating options.

Areas in which the environment is most volatile and where the harm has the potential to be serious deserve careful attention. One of the most urgent is financial risk exposure. Trustees need to know just how volatile the financial environment is. Likewise,



they need to know the level of protection against these uncertainties that the administration has built. Next are those risks that allow the college to be viewed as a party to harm. Risk management plans are largely concerned with this area. The third area that has been growing in volatility and impact on colleges and universities is the risk that a governmental body will opt to reduce or limit financial support or expand costly regulation.

Financial Risk and Contingencies

These questions ask about the volatility of the college or university's economic environment and its preparation for that volatility. They are necessary because financial statements do not present sufficient information to form a complete picture of financial risk.

How volatile are major revenue sources? In other words: What is the risk of a shortfall? Many colleges have faced a good measure of uncertainty in enrollments. Others are seeing new instability in state appropriations. Statistical tools may be used to demonstrate trends in volatility. Enrollment predictability may be increasing, while governmental support is becoming less predictable. Only if trustees and administrators have a clear picture of revenue shortfall risks can they confidently approve adequate financial reserves.

A good response will portray the volatility of each major revenue source and the true amount of control the institution has over each source. Institutions should understand the factors—from enrollment trends to the mood in the state capital—that drive revenues up or down. Institutions may use enrollment models as one way to reduce uncertainty, incorporating factors, such as expected graduations, retention rates, rates of transfer, and re-enrollment rates, to better understand tuition revenue trends. Comparing previous forecasts to actual results is another method an institution can use to demonstrate that projections are becoming more sophisticated.



How has the institution guarded against revenue projections that may be too optimistic?

In other words: What is the contingency plan? Colleges and universities need to be prepared for all possible levels of disappointment and pleasant surprise. The preparation in terms of financial reserves and budget flexibility should match the risk inherent in the revenue projection. In anticipation of a divergence from revenue expectations, the college or university should have reserves, austerity plans, and early warning systems. The college or university should have plans for weathering a worst-case scenario. This is another excellent area for benchmark comparisons. The institution may be able to demonstrate that it has a high level of reserves for the size of its budget when compared with institutions facing similar uncertainties.

What are the college or university's obligations, besides those that are visible on the balance sheet? In other words: What are the trends in off-balance-sheet liabilities?

Financial statements do not reveal all obligations. An institution should also have an analysis of potential commitments, comparing them against available contingent resources. Deferred maintenance and litigation exposure are two obvious liabilities. When an institution announces a plan to bring salaries to a certain nationally competitive level, another commitment is made. Student financial aid packaging that does not cover all need is another type of potential commitment.

*How does this college or university predict cash needs? In other words: Will we have trouble making a future payroll? While cash outflow requirements for most colleges and universities do not vary greatly from month to month, the main *inflow* of cash tends to occur only during three or four months of the year. Heavy inflows take place near the starts of semesters and drop precipitously during the year, with the lowest points often in the summer. Most colleges maintain strong working capital positions. At a few institutions, however, deficits, heavy fixed asset spending, or optimistic transfers to illiquid investments have drained cash. These are the institutions that must reply to this question with the greatest depth. A board would be comforted to see careful cash forecasts and ready options, such as lines of credit or spending controls, already developed in preparation for cash low points.*



What is this college or university's current debt capacity? In other words: How much more could we borrow in a cash emergency? Even trustees at colleges with strong financial positions should pay attention to the response to this question. Trustees can benefit from the perspective of rating agencies and potential lenders. Factors that might be examined include evaluations of the college's financial health and the availability of collateral. The amount that could be borrowed in certain situations may be a last resort in emergencies, but it is the beginning point of capital planning.

Risk Exposure and Insurance

Many colleges and universities have begun broad programs of awareness that engage the entire campus community in reducing potential perils. These programs bring the responsibility for decreasing risk to the whole college community and result in lowered exposure, reducing the risk of tragedy. These programs also help hold down insurance costs. Everyone in the campus community has a role in helping spot unsafe conditions, providing options to excessive student drinking, and taking seriously the mental depression that can precede youth suicide. The board should strongly back the president as he or she leads on these issues.

What new risks are on the horizon? In other words: Can we avoid bad surprises? Thirty years ago, administrators spent little time devising intervention policies for at-risk students. Today, with campus suicides too often in the headlines, more colleges and universities are testing more intrusive responses to key signs. Colleges and universities are also finding that they can mitigate dangerous student drinking habits. Colleges and universities do not have to wait for a suit or a tragedy to examine policies. Administrators must be scholars of the events on other campuses, taking these problems seriously before they occur.

A college or university must be tracking and reacting to its ever-changing risk environment. Litigation against a college or university anywhere in the country could next occur at your institution. Successful litigations often signal that an institution has



failed to take adequate precautions. An administrative analysis of internal loss trends will also assist in preparations.

What is the institution's strategy for involving everyone in loss prevention? In other words: Are we risk-aware and risk-averse? Trustees should learn about any program designed to make all members of the college or university community aware of the difference between proper behavior and risky behavior. Colleges and universities should have codes of conduct and the associated education programs on substance abuse, harassment, safety awareness, discrimination, conflict of interest, professional standards, theft prevention, speech (libel, riot), and fraud. The board should expect to see careful due process spelled out in each policy for those accused of violations. An excellent response would show examples of how risk management teams have averted possible losses. Many colleges and universities have initiated peer programs for reporting safety hazards. An interesting response would also delineate the roles of risk managers and the internal audit division.

How is the college managing the cost of risk insurance? In other words: Are insurance costs under control? Risk reduction programs will be financially ineffective if the institution is not managing its insurance well. At many colleges and universities the administration of insurance and the management of risk have gone from a minor chief financial officer function to the responsibility of a professional team. Trustees are often eager to learn of this increase in professionalism. Trends in the cost of risk insurance should prove helpful in response to this question. Details on membership in risk-sharing consortia, as well as strategies for self-insurance and policy renewal would also be appropriate as part of a response.

Regulation and Appropriations Risks

New, and often sudden, regulations, such as those recently aimed at monitoring foreign students for security risks, have added significant operational costs to the budgets of colleges and universities. Compliance and oversight can be expensive. Regulations on



workplace and environmental safety have surprised a number of institutions. Limits on property taxes, forcing greater state dependence on income taxes, have put many universities at the mercy of the economic cycle. Appropriation cycles will grow increasingly out of sync with economic swings as states increasingly focus spending on health care and prisons while higher education gets only what is left over. Trustees should understand the risks and be assured that the college or university has taken a proactive stance.

How dependent are we on continued favorable legislation? In other words: Could the state or federal government pull the rug out from under us? Many colleges and universities both private and public remain surprisingly dependent on state appropriations and/or student tuitions that are heavily supported by federal grants, state grants, and guaranteed loans. No program is immune to reduction. Trustees should become familiar with the proportion of expenditures that each governmental program supports either directly or indirectly through tuition grants or financing. Because students may borrow in excess of tuition for living expenses, the total proportion of expense funding for some colleges from all direct and indirect governmental sources can exceed 100 percent. Trustees should be aware of the risks inherent in any high dependency on government support.

What adverse regulatory actions could be on the horizon? In other words: What's happening in Washington and the state capital? No college is completely powerless in the face of potentially damaging regulations. Being able to explain to a lawmaker the potential impact of proposed regulations can influence legislative support for the regulation, regardless of the size of the college or its "presence" in a capitol. Institutional leaders should be ready to present the role of the committee charged with regulatory oversight and the sources of information used by committee members. Trustees need to know that administrators and faculty members are being asked about the possible impact of new measures and that responses are planned in the face of any potentially difficult changes.



The language of risk is difficult to master. Explaining exposure is as challenging as explaining the future. Expressing the level of discomfort with any given risk exposure contains as much ambiguity as scoring an Olympic diver. Colleges and universities must rely on a measured view of history to speak of the risks of the future. Trustees dig deeply into the memory of a world of good and bad judgments to assess the danger of exposure.

Responses to the questions offered in this chapter must be built on evidence. The responses also require that a college administration not take the future for granted. The future is never a straight line drawn from the past.