



Taking the right path*

Sarbanes Summit



*connectedthinking

PRICEWATERHOUSECOOPERS PwC

Sarbanes Summit

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Summit on Sarbanes-Oxley

Panel Discussion

The Sarbanes-Oxley Act of 2002 (“Sarbanes” or “SOX”) was signed into law in July 2002. Although Sarbanes does not apply directly to colleges and universities, it has focused attention on their governance, management and audit-related practices. In the years since Sarbanes’ enactment, NACUBO, PricewaterhouseCoopers and others have published recommendations for colleges and universities, but practical guidance specific to colleges and universities has been lacking, which was the motivation behind the Sarbanes Summit.

The idea of holding a “Sarbanes Summit” for higher education leaders developed when Molly Broad, then the president of the University of North Carolina, and Jay Morley, the president and CEO of NACUBO, discussed bringing a group of presidents and business officers together to jointly discuss the issues. PricewaterhouseCoopers offered to underwrite the Summit, which was held on June 1, 2005 for a select group of higher education business officers and presidents. The objective was to identify—several years after its enactment and with the benefit of initial corporate implementation behind us—the Sarbanes-like provisions that make the most sense for colleges and universities and how institutions would voluntarily implement them.

Molly Broad opened the Summit, giving a president’s perspective on the issues. Jay Morley urged participants to be proactive and consider how to let the public know that higher education institutions are doing the right things. John Mattie from PricewaterhouseCoopers shared the firm’s insights into the state and federal Sarbanes-like legislation that may affect colleges and universities in the coming year as well as lessons learned from corporate implementers of Sarbanes. NACUBO shared the results of its recent survey of more than 2,000 member institutions, which was designed to follow up on its 2003 Advisory Report and capture current and planned governance and senior management Sarbanes-related practices.¹ Facilitators from NACUBO and PricewaterhouseCoopers led breakout groups of Summit participants regarding the four areas the group as a whole had chosen to focus: internal controls, certifications, governance and risk management. Before the Summit, participants were asked to rank possible topics, and as a result of that process, these four areas were selected.

In her opening remarks, Molly Broad pointed out that part of the enduring strength of higher education is its continuing commitment to values (like integrity, truth, openness, excellence, fiduciary responsibility, etc.) and to our ability to sustain alignment with the priorities of our many interested constituencies. It is in the enduring commitment to values that SOX becomes very important. When universities are perceived as behaving in ways that are not aligned with integrity and fiduciary responsibility, we lose credibility that undermines our strength.

This paper is designed to help board members as well as presidents, officers and managers of colleges and universities learn more about what others are doing and might do in their efforts to develop an institutionwide response in each of the four following areas:

- Governance
- Internal controls
- Certification
- Enterprise risk management

01. Introduction

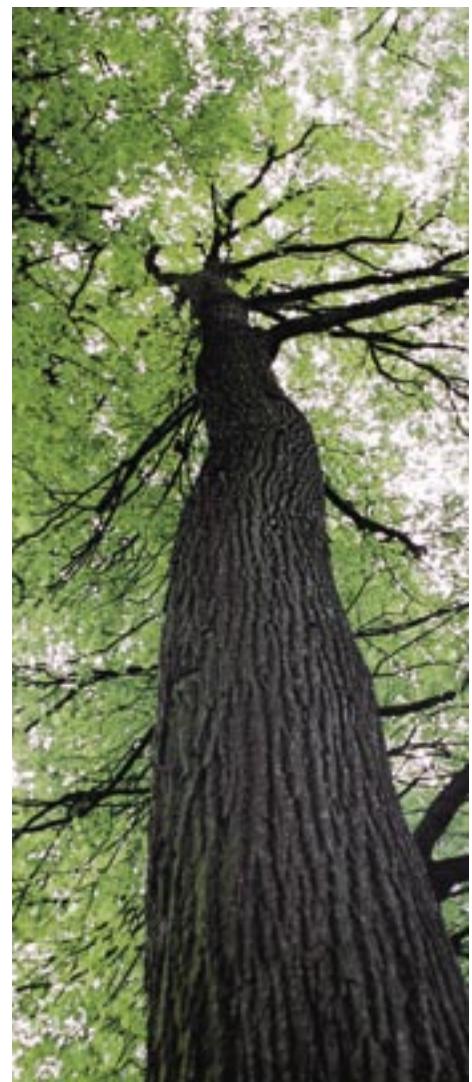
Sarbanes is the most significant reform in the securities laws since they were first enacted in the 1930s. Its objective was to improve investor confidence in financial reporting and, more generally, in financial markets after several well publicized corporate failures, including Enron and WorldCom.

Sarbanes applies directly only to issuers of publicly traded securities,² generally for-profit corporations, but it has ushered in changes in the ways that audit committees, management, and independent auditors of all types of organizations interact. At its heart, Sarbanes calls for greater accountability for individual business leaders as well as greater accountability entitywide.

The push for more accountability didn't begin with Sarbanes, however, and it probably won't end there. Several states have enacted or are considering Sarbanes-like legislation for public charities. California's Nonprofit Integrity Bill became effective in January 2005. Massachusetts and New York filed proposed legislation in 2005.

At the federal level, the U.S. Senate Finance Committee and the House Ways and Means Committee held hearings in 2004 and 2005 about the activities of public charities. Independent Sector convened the Panel on the Nonprofit Sector after the Senate Finance Committee's first hearing, and the Panel released its final report in June 2005. Major reforms have not yet been incorporated into legislation, but it could happen this year. Also, it is possible that the Government Accountability Office (GAO) may establish Sarbanes-like requirements for recipients of federal funding.

In the following sections, we summarize the discussions at the Sarbanes Summit around four issues beginning with governance, then internal controls, certification, and risk management. We present each issue, why it's important for higher education, what the Summit findings were, which federal or state proposals might affect the issue, and how institutions might implement a solution.



02. Enhancing accountability

Enhancing accountability through governance

What is governance and why is it important?

Governance is defined as follows:

"At its broadest, corporate governance encompasses the framework of rules, relationships, systems and processes within and by which fiduciary authority is exercised and controlled in corporations..."

...Key elements of good corporate governance principles include honesty, trust and integrity, openness, performance orientation, responsibility and accountability, mutual respect, and commitment to the organization..."³

Why is good governance important to higher education? First, the board sets the all-important tone at the top (i.e., the control environment), and is in itself a control (i.e., a monitoring control). The board represents the interests of institutional stakeholders, such as bond holders, students, parents, legislators, donors and others. The effectiveness of the governing board is one factor that bond rating agencies evaluate when setting a rating. Fund-raising may suffer if the governing board is not viewed as a good steward and, conversely, it is possible that donors might be more generous if they believe that the governing board is effective. From an operating and strategic perspective, experienced, well-credentialed board members bring skills and perspective that are invaluable to management.

What are the current governance practices of colleges and universities?

In the post-Sarbanes environment, much of the attention was initially directed at audit committees. NACUBO's survey questioned business officers about audit committee activities. The results are highlighted in the following chart.

NACUBO survey results about audit committees

Question	Public institutions	Private institutions
Institution has an audit committee?	88%	95%
Audit committee has charter?	71%	74%
Committee includes at least one financial expert?	73%	95%
Committee oversees annual financial statement audit?	89%	99%
Committee involved in selection of external auditor?	67%	96%
Committee evaluates performance of external auditor?	52%	85%
Audit engagement letter addressed to audit committee?	50%	66%
External auditors report to audit committee?	59%	81%
Committee preapproves nonaudit services performed by external auditor?	38%	56%
Auditor's lead partner rotates every seven years?	37%	52%

NACUBO's survey suggests that most public and private institutions have separate audit committees with at least one member as a financial expert and charters delineating their responsibilities. Most committees are involved in the selection of the external auditor and most oversee the annual audit.

A focus of Sarbanes is the audit committee because of its responsibility for financial reporting. Section 301 of Sarbanes says that issuers of publicly traded securities must have an audit committee or the full board must fulfil the audit committee's role. Each member of the audit committee must be "independent"⁴ and one member should be a "financial expert."⁵ Section 301 of Sarbanes also stipulates that the audit committee be responsible for all facets of the relationship with the independent auditor.

More recently, the discussion of governance has broadened beyond the role of the audit committee and financial reporting. For example, note the proposal to require governing board approval of executive compensation in the following chart.

The chart below summarizes the governance-related proposals made by the Panel on the Nonprofit Sector as well as those made by the states of New York and Massachusetts. In addition, the chart summarizes the governance provisions of the legislation that was enacted in California and New York.

What does Sarbanes require and what has been proposed for not-for-profit organizations?

Federal, state or other initiative	Impact
Panel on the Nonprofit Sector (proposed)	<ul style="list-style-type: none"> • Board would approve executive compensation • Would establish minimum standards for board (e.g., size) • Half members must be independent to retain exempt status • Would be required to disclose board compensation, if any
California Legislation (enacted)	<ul style="list-style-type: none"> • Board must approve executive compensation • Audit committee required if revenues > \$2m, except for colleges, universities, and hospitals
New York Legislation (enacted)	<ul style="list-style-type: none"> • Primary purpose is to provide for the dissolution of a nonprofit corporation
New York Legislation (proposed)	<ul style="list-style-type: none"> • Audit committee encouraged if revenues/support > \$2m • Executive committee encouraged if board > 25 members • Audit committee members must be independent • Board must establish complaint procedures • Board must approve officer compensation
Massachusetts Legislation (proposed)	<ul style="list-style-type: none"> • Audit committee required (or full board) if revenues > \$500K • Board must certify audited financial statements • Audit committee members must be independent • Excess benefit transactions prohibited • Compensation must be reasonable

What were the Summit findings?

Sarbanes-like governance proposals

Despite differences between governing boards of for-profit and not-for-profit organizations, they share the same overall goals—helping their organizations improve and succeed. Molly Broad, president of the University of North Carolina System, noted: “Be mindful of our governance structure and remember how unique our culture is. But we can’t hide behind our governance and culture. We need to adopt Sarbanes in our own unique culture.”

Summit participants reinforced Ms. Broad’s comments noting that institutions of higher education have long-standing formalized governance structures in place. In fact, the large number of positive responses to governance questions in the NACUBO survey might also suggest a longer history of paying attention to governance. The overarching assertion from summit attendees indicates that higher education should positively build on existing organizational structures.

Participant suggestions for industry advocacy included:

- Work with the Association of Governing Boards (AGB) as well as with the presidential associations, such as the American Council on Education
- Identify a board champion in each of these associations
- At a national level, develop a template or “toolkit” that can be used to orient new board members
- Gather and publish a compilation of case studies or best examples of applying governance techniques that enhanced transparency and accountability. Such illustrations should demonstrate handling issues, cultural change and trustee competencies.

Participant suggestions for colleges and universities included:

- Commit time and resources to the education and training of board members.
- Propose that governing board members conduct a self-assessment of their performance at regular intervals. (A self-assessment tool for board members can be found in *Audit Committee Effectiveness—What Works Best*. A second tool is the *AICPA Audit Committee Toolkit: Not-for-Profit Organizations*.⁶)

Colleges and universities have “shared” governance models that include the board, faculty committees, state councils and other governmental bodies. The group suggested the following ideas for working with various campus constituencies:

- Find ways to educate faculty about Sarbanes-type issues. It's important to raise the awareness of faculty and have a productive partnership with the business office.
- Find supporters among the deans, and ask them to help raise the faculty's awareness.
- Create partnerships between the board, the president and the CFO. Many presidents sit on corporate boards where they might be exposed to Sarbanes and predisposed to its applicability on campus. Such presidents would be a valuable ally of the CFO.

One of the board's responsibilities is approving executive compensation packages as well as compensation for other highly paid individuals. The board may delegate this responsibility to the executive or compensation committee or, alternatively, the entire board can be responsible. Trustees should make sure that compensation and benefit packages for executives and other highly paid individuals are reasonable when compared to those of other similar organizations.

Ideally, the skills of board members will complement those of senior institutional leaders. Some institutions may want to actively recruit new members with specific skills. Orientation for new board members and training programs for all board members would help them be most effective. Annual retreats may be useful for dealing with complex issues that require concentrated focus (e.g., Sarbanes).

One Summit participant noted that his institution had found it helpful to assess the performance of the board and senior management at the same time and to talk through the issues together.

Another leading practice that Summit participants discussed was effectively using internal audit to support the board. Internal audit should report to the board (usually the audit committee) and be viewed by members as an important board resource. The internal audit director

should be proactive and cultivate good relationships with board members, management, and the external auditors, while recognizing that the function must remain independent.

The Summit participants discussed the importance of ethics training. Institutions should adopt a statement of ethical values to which everyone on campus would be held accountable. For it to work, however, it has to be apparent that the president and the board are abiding by it. As one person noted, Sarbanes “goes right to the heart of ethics.” Another participant commented, “Ultimately, it comes down to people.” People have to do the right thing.

Participants saw many benefits to enhancing governance, including:

- More effective board members who ask the right questions
- More productive staff and improved morale on campus
- An increasingly positive perception of higher education

Using internal controls to enhance accountability

What are internal controls and why are they important?

Internal controls are defined as: “A process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations”⁷

Five interrelated components must be in place in order for internal controls to be effective:

- 1) Monitoring, a review by a supervisor of an employee’s work, for example
- 2) Information and communication, identifying and collecting the right information and then communicating it widely across the campus community in a policy manual, for example
- 3) Control activities, the policies and procedures—a bank statement reconciliation, for example—that management establishes to help ensure that its directives are carried out
- 4) Risk assessment, identifying institution-specific risk and establishing appropriate internal controls to manage it
- 5) Control environment, setting the tone at the top from directors and officers, including, for example, a written code of conduct so that everyone is aware of expected behavior

Why are internal controls important? They play a valuable role for for-profit or not-for-profit institutions. When working properly, internal controls:

- Ensure effective external and internal financial reports, risk management, institutional compliance and operations
- Lead to meaningful accountability, certification and governance

What are current practices for internal controls?

The following chart presents the results of NACUBO's survey, which indicates that management of many public institutions already delivers internal control reports to the audit committee. However, the response to the second question (below in the chart) indicates neither public nor independent institutions would be prepared if an assessment of internal controls were required in the near term.

NACUBO survey – internal controls

Question	Public institutions	Independent institutions
Does management report periodically on internal controls to the audit committee?	51%	38%
Has the institution already planned how an assessment of internal controls on its campus(es) could be conducted?	36%	17%

The American Institute of Certified Public Accountants (AICPA) has proposed revisions to its Statement on Auditing Standards (SAS) No. 60, *Communication of Internal Control Related Matters Noted in an Audit*. The revised SAS would require auditors to report deficiencies in internal controls (specifically “significant deficiencies” and “material weaknesses”) to the governing board. The bar will be lowered such that a greater number of control deficiencies could be considered serious. It is possible that the Government Accounting Office (GAO) would follow suit and require that the deficiencies be reported to federal agencies in OMB Circular A-133 reports. We encourage institutions to monitor the progress of the AICPA’s standard and to monitor actions of the GAO.⁸

According to Section 302 of Sarbanes, management is responsible for the effectiveness of internal controls and must evaluate their effectiveness and disclose any deficiencies to the audit committee and the external auditor. Under Section 404 of Sarbanes, the external auditor attests to management's assertion on the effectiveness of internal controls related to financial reporting. Sections 302 and 404 are the most onerous of Sarbanes' requirements, and the most costly to implement. Like all of Sarbanes, Sections 302 and 404 are required for issuers of publicly traded securities. Implementing Sections 302 and 404 would be voluntary for not-for-profit institutions.

NACUBO recommended in its Advisory Report 2003-3⁹ that institutions start identifying and evaluating the adequacy of their controls over financial reporting. They should plan how an internal control assessment would be conducted. They also should consider certification and subcertification, including of internal controls, if their financial statements are publicly disclosed. From an oversight perspective, the audit committee should periodically ask management whether internal controls are adequate. Also, internal audit should report periodically to the audit committee and management on the adequacy of internal controls.

According to Massachusetts' proposed legislation, the audit committee would be responsible for recommending to the board measures to ensure that internal controls are documented by management and evaluated as part of the audit. At the time of this writing, the proposed legislation is still in committee.

New York's proposed legislation (bills S05235 and A07825) focuses on controls over financial reporting. It stipulates that internal controls must be maintained to reasonably ensure that material financial information is made known to the board. Also, officers must disclose to the board and auditors significant deficiencies and material weaknesses in the design or operation of internal financial controls as well as fraud, whether or not material, that involves management or other employees who have a significant role in the organization's internal controls. In addition, management must disclose any material result that indicates that financial information does not fairly present in all material respects the financial condition and results of operations for the periods presented. At the time of this writing, the proposed legislation is still in committee.

The Panel on the Nonprofit Sector did not make recommendations about internal controls. However, the Panel noted that the board is responsible for "reviewing adoption and implementation of internal financial controls through the audit process."¹⁰

What does Sarbanes require and what has been proposed for not-for-profit institutions?

What were the Summit findings?

Ideally, Summit participants encouraged colleges and universities to conduct a comprehensive risk assessment and then assess and enhance internal controls around the biggest risks. In all likelihood, financial reporting risk would not be one of the biggest risks for most institutions. Practically speaking, the participants concluded that a limited assessment of internal controls over financial reporting conducted in the “spirit of Sarbanes” but without external attestation would be manageable and worthwhile. As one participant commented, “It would be a healthy exercise to do an assessment around major accounts on the balance sheet and income statement to put a stake in the ground.” Other participants echoed these views:

- “When you have been on a campus for several years, you know where the mistakes are made, and you know the vulnerabilities. Work on those first.”
- “We already see things that should be improved. Let’s solve those problems first.”

Unless they were new to their jobs, most Summit participants believed they already knew—like the two participants quoted above—which controls would most need their attention. Unless required by external regulators, most participants felt that a complete assessment of controls over financial reporting would not be worth the time and expense.

Many also felt that controls needed to be viewed more broadly than the traditional “Sarbanes” definition—consideration should be given to addressing controls around the operating components that support institutional objectives. It would serve higher education well to align controls with the risks surrounding its key institutional objectives (e.g., increasing the research base). Another common observation was that departmental areas should receive attention. Specifically, operational and financial responsibilities should be documented, training should occur and processes made transparent.

Leading internal control practices from Sarbanes Summit participants

Sarbanes Summit participants are already engaged in enhancing their internal controls. The following chart presents several leading practices that they are employing. Many of the practices involve working with decentralized units. In order to enhance the institution's internal controls, central finance must find ways to work effectively, either formally or informally, with decentralized units or departments.

One public institution created a full-time position for a financial officer with expertise in internal controls who would consult and provide training to departments. (For smaller institutions, it might be possible for several institutions to share such a resource.)
Hire and train financial officers centrally, then export them to decentralized units.
Perform financial transactions for departments or standardize the way such transactions are done, as much as possible, and improve the controls. In other words, do the job for them, and then you know it's done right.
Set up an "Advisory Group" that is staffed from the business office (and an internal audit representative – if possible). The CFO (or designee) should attend meetings and offer to help where applicable, including identifying areas where internal controls could be improved.
Find a way to become involved in the hiring of financial officers in decentralized units so that you can make sure they have the right skills, including expertise in internal controls.
Use internal auditors as financial control experts. They understand processes and related controls.
Make sure the responsibility for internal controls is written in relevant job descriptions. If it's not there, it is less likely to get done.
Invite deans to relevant audit closing meetings where they will be exposed to financial and controls issues.
Watch your language—higher education is not a "command and control" environment. Talk about "responsibility" rather than "control." Use positive words, and adopt an upbeat tone of voice. If at all possible, identify a tangible benefit for each constituency. For example, why should a faculty member be interested in enhancing internal controls? Find a way to make it in his or her interest to enhance controls.
Educate the provost about internal controls; if the provost supports something, faculty will be more likely to fall in line.
Think of Sarbanes as the perfect opportunity. "Isn't this an opportunity to raise the level of awareness about control-related issues," a participant commented, and to "look for ways to make the issues compelling."

What is certification and why is it important?

Using certification to enhance accountability

What is certification? Senior officers would sign documents (i.e., certify them) or provide oral assurance to the audit committee or others to verify that financial reports are reliable and that internal controls are working as intended. Certification of financial reports and internal controls over financial reporting are intertwined. Senior officers would not be able to certify financial reports unless they believed that the internal controls over financial reporting were working effectively.

Why is certification important? Internally, certification raises awareness of responsibility and who is accountable. It also helps identify control gaps and training needs. Chances are that training will lead to a more reliable process and greater accountability.

From an external point of view, financial statement users can take greater comfort in the reliability of financial reports and the effectiveness of internal controls if they are certified. If people are willing to personally certify a financial report, then they must be confident in its reliability.

Some higher education institutions already require certification of financial results. Among those that do, CFOs are most likely to certify, and some of them obtain manager subcertifications. Also, it is an evolving practice to include in annual financial reports a statement of management's responsibility for their completeness and accuracy.

What are current practices for certification of financial results?

The following chart presents the results of NACUBO's survey, which indicates that officers of public institutions are more likely to certify the financial statement or financial results than are officers of independent institutions.

NACUBO survey results—certification

Question	Public institutions	Independent institutions
CFO already certifies financial statement?	53%	25%
CEO already certifies financial statement?	41%	19%
Financial managers certify financial results?	42%	30%
CFO signs the Form 990?	53%	81%

What does Sarbanes require and what has been proposed?

Under Section 302 of Sarbanes, the president or CEO and CFO of a company with publicly traded securities must make very broad certifications. They must certify the financial report to confirm that:

- Based on their knowledge it is true and does not omit material facts
- The information in it fairly presents the institution's financial condition and results of operations

In addition, the signing officers must certify that they:

- Are responsible for internal controls
- Have designed internal controls such that they worked effectively during the reporting period
- Have reported material deficiencies in them, or fraud or significant changes, to the auditors and the audit committee

Finally, the signing officers must certify that they have evaluated the effectiveness of the controls and prepared a report that includes their conclusions about the effectiveness of the controls. The latter is where Sarbanes Sections 302 and 404 intersect—the assessment by management of internal controls.

According to NACUBO, if institutions publicly disclose financial statements, they should consider CEO and CFO certification of financial results. They also should consider subcertification of financial results by financial leaders of units, departments or schools.

Under New York's proposed legislation, the CEO and treasurer or CFO would be required to certify that the financial reports are "true and correct to the best of their knowledge."¹¹ The financial reports must be accompanied by an opinion from an independent public accountant.

Originally, the proposed Massachusetts legislation would have required certification by the chair of the governing board as well as by the CEO. Now it appears that the CFO may be required to sign the annual report, a copy of which must be provided to all members of the governing board.¹²

Requiring certifications of financial results would seem to be straightforward. However, consider the following points:

- Would the CEO and CFO certify the financial report in the hope that it's right? How would they be confident the financial report is complete and accurate?
- Does the institution have decentralized units that provide essential financial data to central finance?
- Do business officers in these units have a deep enough understanding of the institution's controls as well as of its policies and procedures? Do they have strong financial skills? Was central finance given a chance to evaluate their skills in this area before they were hired?
- Can certifications be meaningful if outside parties are involved in a process (e.g., alumni, joint venture partners)?
- If there are multiple handoffs of financial data, should the institution require an equal level of subcertification from each department involved?
- Would the CEO and CFO certify financial information or business practices or both?

Answers to such questions should be considered carefully before implementing certifications. Earlier we said that we would discuss in this section primarily certifications of financial results rather than certification of internal controls, but now we see how closely certification of financial results depends on strong internal controls over financial reporting. Management can meaningfully certify financial reports only after it is confident that internal controls over financial reporting are effective across all departments and activities.

What were Summit findings?

Although the term “certification” may not be used, many certifications already exist in higher education. Examples are the IRS Form 990, the Disclosure Statement (DS-2) required by OMB Circular A-21,¹³ eZ-Audit required by the Department of Education, Data Collection Forms¹⁴ required under OMB A-133, audit representation letter, and certification of compliance with rules and regulations that accompany the OMB Circular A-133 report. Summit participants thought we should begin by asking institutional leaders what they already certify, then assess their comfort level with the current certification, and create a gap analysis as a starting point. It would be a good business practice to improve current certifications—if needed—before creating new ones.

The culture of higher education is collegial and collaborative. When asking for a certification, a person’s reaction might be: Don’t you trust me? Reassure fears by pointing out the possible benefits of certification. For example, certification raises the awareness of each individual’s contributions. Often, the institution realizes that training is needed, which is an investment that can make an individual, and his or her certification, even more valuable. Sometimes, weak links (or individuals who are not contributing their share) are identified and changes are made that improve the group’s morale.

Summit participants felt strongly that fiscal training and accountability programs should become part of the culture and a prerequisite to certifying financial results. The industry should consider:

- Leveraging strong fiscal training programs already in existence
- Developing a model for a fiscal reporting hierarchy that addresses decentralization by including a reporting line to the CFO

Certification of financial results presumes that internal controls over financial reporting are strong. One leading practice is a “readiness review,” under which an institution would review its existing controls, evaluate their effectiveness, and identify areas for remediation. Remediation would be made prior to the year-end certification.

How would an institution implement certifications? Senior management would propose an implementation plan and the board would review and approve it. After that, an institution might take an inventory of existing certifications and consider how to broaden them.

Participants identified the following benefits of certification:

- Signers of existing certification would do so more knowledgeably
- It supports the principle of "shared responsibility"
- It might enable an institution to improve its bond rating and save money on its external audit



What is enterprise risk management and why is it important?

Enhancing accountability through enterprise risk management

The Committee of Sponsoring Organizations (COSO) of the Treadway Commission published *Enterprise Risk Management—Integrated Framework* in September 2004 with PricewaterhouseCoopers as its author. Enterprise risk management (ERM) is defined as follows:

“Enterprise risk management is a process, effected by an entity’s board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.”¹⁵

Enterprise Risk Management—Integrated Framework expands on *Internal Control—Integrated Framework*; it does not replace it. The ERM framework is designed to satisfy an organization’s need for effective internal controls and effective risk management. According to COSO:

“The frameworks are compatible and are based on the same conceptual foundation. We believe the consistent conceptual underpinnings are a major strength of the two models.”¹⁶

The framework has eight components:

1. The internal environment relates to the organization’s culture, its ethical values, the environment in which it operates, and its risk appetite.
2. Objective setting concerns the process that management uses to set its objectives. The objectives should align with the organization’s mission and be consistent with its risk appetite.
3. An organization sets its objectives, but they are affected by internal and external events (i.e., event identification). Events present opportunities and risks that affect the organization’s achievement of its objectives.
4. Risk assessment is a key component. Organizations must identify risks, assess them, and find ways to manage them.

5. Management responds to risks (i.e., risk response). It might decide to accept them, avoid them, and/or find ways to manage them.
6. Control activities are the policies and procedures that the organization establishes to help make sure that it responds to risks as intended.
7. Information and communication concerns the way that the right information is identified and then communicated to the people in the organization who need it. Communication must flow down, across and up the organization for it to be effective.
8. Monitoring, through ongoing and periodic activities, is an important part of the process. Also, corrective actions should be taken when necessary.

Why is risk management important? There is a strong link between good governance and risk management, and for that reason alone, as well as its relevance to internal controls, ERM is important to our discussion.

What are current risk management practices?

Some colleges and universities are already using risk management techniques. According to NACUBO's survey, 49% of public and 31% of independent institutions have performed risk assessments and documented key financial processes. In PricewaterhouseCoopers' experience, more governing boards are focusing on broad institutional risks, including nonfinancial, reputational, operational, and strategic risks rather than financial reporting risks. Other observations are summarized in the following chart.

Use of risk management in higher education

Question	How many institutions?
Have universities designated an individual to be responsible for risk management/compliance?	Majority
If this person is other than the internal auditor, is there a formal coordination strategy with internal audit in place?	Some
Has the university risk management function obtained information from the external auditor concerning its views of risks to the university?	Some
Has the designated person either conducted or coordinated the performance of an entitywide risk assessment within the past 18 months?	Some
Does this person report periodically to the audit committee?	Many
Is there a formal strategy to communicate risks assessed as significant to other board committees and/or the board as a whole?	Few
Have the results of the updated risk assessment been considered in determining the resources available and the audit plan of the internal audit function?	Few
Is there a plan in place to make enterprise-wide risk assessment and response a sustainable process as compared to a project conducted periodically?	Few

Sarbanes does not propose that organizations adopt risk management and neither do the Sarbanes-related initiatives to date. NACUBO has not proposed that institutions adopt risk management, other than as a way to manage compliance.¹⁷ Also, federal and state Sarbanes-like proposals have not included requirements related to risk management.

However, risk management and effective internal controls go hand-in-hand. A best practice would be to assess risks and then enhance the related controls. (A third step would be to implement certifications of the internal controls over the areas of highest risk.)

Several years ago, PricewaterhouseCoopers and NACUBO conducted a forum of college and university business officers and other thought leaders to discuss risk management and how institutions might implement it. Interested readers could find the paper that we published after the Forum, *Developing a Strategy To Manage Enterprisewide Risk in Higher Education*, at: <http://www.pwc.com/education>.

What does Sarbanes require and what has been proposed for not-for-profit institutions?

What were the Summit findings?

Ideally, Summit participants thought institutions should conduct a comprehensive risk assessment and then assess and enhance internal controls around the biggest risks. However, for most institutions, a comprehensive risk assessment would be "too much to take on" and "too expensive."

Participants identified the following risks:

- Compliance, including sponsored research and athletics
- Financial
- Operational
- Health and safety issues as well as national security issues
- Affiliated organizations
- Facilities management
- Information technology systems
- Reputation and brand
- Legal
- Emergency preparedness and disaster planning

Which risk-related controls have the biggest return on investment? The participants thought that focusing on compliance risk would result in the "biggest bang for the buck" for many institutions, especially research universities, followed by reputational and operational risk. However, the group acknowledged that for all types of institutions the process of reviewing risk needs to be ongoing and that stakeholders need to be involved.

Unless new to the institution, most CFOs thought they would know which risks needed the most attention on their campuses. They would start with the known risks. Ideally, management would bring these risks to the attention of a president's or CEO's cabinet where appropriate policies would be established, alternatives would be discussed, and

the best solution would be implemented. Alternatively, the cabinet or committee serves as a check and balance against the risk areas identified by the CFO.

Because risk identification became a common theme in assessing areas to focus on concerning controls and certifications, an institution's governance structure must be similarly prepared to oversee this process. Because managing risk is ongoing, oversight of such management by a governing body must also be ongoing.

Barriers to an effective risk management program include limited resources, the length of time it takes to make decisions in the higher education environment, and cultural resistance to change. Another barrier is lack of experience with the "tools" required to implement a risk management program (e.g., a risk matrix).

Several benefits of establishing a risk management program are:

- Improved reputation
- More efficient operations
- Resource allocation — money could be directed to the right place, the areas of highest risks
- Campus sense of pride in a well-managed and disciplined institution
- Lower insurance costs

03. Overcoming the barriers

In the discussions about each of the four areas discussed in this paper, participants also identified the implementation barriers. After the final breakout group report, we came together again as a single group to discuss how these barriers might be overcome. This section presents the results of the group's discussions.

As always, time and money are the biggest barriers to doing "things" differently, including enhancing internal controls, employing new risk management techniques, improving governance practices and implementing certifications. In particular, getting the time and attention of senior leaders can be difficult; decision making in higher education's collaborative culture can be frustratingly slow; and getting access to information technology resources, which are always in short supply, can be challenging. Nevertheless, Summit participants had many suggestions, including those in the following chart.

Recommendations for overcoming the barriers

Get top-level commitment for a new initiative. If board members and senior leaders, including the president, think an initiative is important, then others are more likely to be willing to spend time and money to get the job done.

CFOs should look for opportunities to partner with:

- The audit committee and the president or chancellor—their support will help overcome barriers.
- Internal audit—internal auditors report directly to the audit committee. Be a sounding board, and in a collaborative manner, help internal audit succeed.
- The external independent auditor—the independent auditor also reports to the audit committee, and can help the CFO focus the audit committee on the right issues.
- Deans—look for supporters among the deans. They can help get the support of faculty.
- Other senior officers—it's helpful if senior officers hold their reports to similar standards and apply disciplinary actions consistently. When some managers do not hold employees accountable, it makes it harder for other managers to expect the right behavior.

Work with peer groups. For example, the Association of Governing Boards of Universities and Colleges (AGB) might be interested in having a CFO speak to a group of trustees about a timely financial issue. Educate trustees in general and it may eventually help you with your own board.

Don't lose sight of reputational issues. For example, at some institutions the athletic department may not be material financially, but it may be a huge reputational risk, and you can justify focusing on it for this reason.

Recommendations for overcoming the barriers, continued

Take a series of incremental “first steps.” Perhaps you don’t have the time or money to focus on the whole, but if you focus on one piece of an important project this year, and another piece next year, you will eventually get the job done.
Find ways to make an issue a priority or a project compelling. Sell it widely—presentations, newsletters, training, email, one-on-one conversations, meetings—using language that is likely to have broad appeal. “Package” the idea as if you were conducting a marketing campaign. If you don’t keep it on the front burner, neither will others.
Before you make an issue a priority for others, make sure that it is your priority. You have to make the number of priorities you are focusing on manageable.
Take the long-term view of funding. If you don’t get the budget dollars the first year, try again the next year and the year after. Also, be willing to spend some of your budget dollars on an initiative.
Make sure new responsibilities are incorporated into employees’ formal goals for the upcoming year and hold them accountable for achieving them. If new responsibilities become long-term expectations, then make sure they are built into the employee’s job description.
Find ways to move the culture forward without being the police. Find ways to help people “do the right thing.” Remember that you are all on the same team.
Get to know people outside central finance. Meet departmental leaders. Join committees in decentralized units where you can add value and help avert problems.
Develop standard procedures for accomplishing tasks that lend themselves to this approach (for example, routine journal entries). Then handle such tasks in central finance where you can be certain they are done right.
Don’t underestimate the importance of training. New employees need training, but so do long-term employees to reinforce expected behaviors and to learn new behaviors. Senior management and boards need training too. There should be training for soft skills (e.g., leadership) as well as for technical skills.

Most participants believed that the benefits of overcoming the barriers would be well worth it. They cited factors like the following:

- Morale would improve.
- People would feel good about working at the institution.
- We would enhance public trust.
- Reputation would improve and operations would be more efficient.
- We would be anticipating problems before they occur and that’s a good thing.
- Bond rating might improve.
- We would be doing the right thing by being proactive.

04. Conclusion

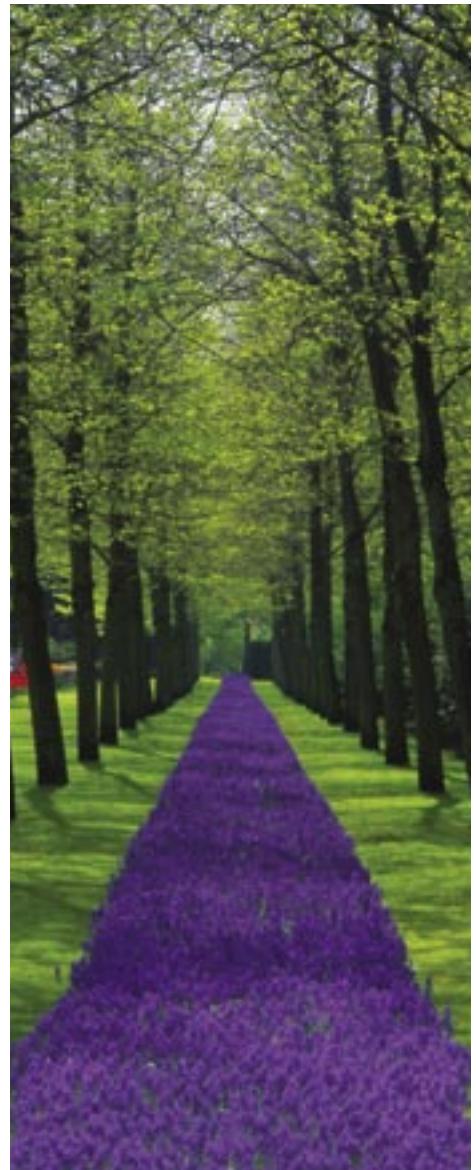
The Sarbanes Summit brought together a group of college and university presidents and business officers to discuss and make recommendations about:

- Governance
- Internal controls
- Certification
- Enterprise risk management

Although Sarbanes does not apply to colleges and universities, becoming more "accountable" to stakeholders very much applies to them, and accountability is at the heart of Sarbanes. The four areas we discussed at the Summit share at least one characteristic—they help institutions become more accountable.

- Internal controls help ensure that the preparers of an institution's financial reports are held accountable for the report's reliability, while management is held accountable for efficient operations and everyone is held accountable for compliance.
- Certification documents accountability; by signing their names, individuals acknowledge publicly that they are accountable.
- Governing boards are accountable for representing the interests of stakeholders.
- Enterprise risk management holds institutional leaders accountable for identifying, and then managing, the risks that would prevent the institution from accomplishing its objectives.

Both Molly Broad and Jay Morley emphasized that we have an opportunity to raise the level of awareness about these issues. Improving accountability is the opportunity for colleges and universities currently. The Summit participants concluded that higher education institutions can improve accountability by making enhancements to internal controls and governance practices and by implementing certification and enterprise risk management.



Footnotes

- ¹ “On the Transparency Track,” by Sue Menditto and Jessica Shield, NACUBO Business Officer magazine, May 2005 edition, which is available to NACUBO members at www.nacubo.org.
- ² Issuers of publicly traded securities are generally corporations. They issue securities (e.g., stocks, bonds) that are traded on one of the security exchanges (e.g., the New York Stock Exchange) in the U.S.
- ³ From Wikipedia, a web-based, free-content encyclopedia that contains approximately 1.6 million articles and is at www.wikipedia.org.
- ⁴ The definition of “independent” in Sarbanes is a person who is not affiliated with the organization or its subsidiaries (other than as a trustee). Also, audit committee members would not be independent if they accepted, directly or indirectly, any consulting, advisory, or other compensatory fee from the organization apart from any fees they may receive as members of the board of directors and its committee.
- ⁵ The Securities and Exchange Commission (SEC) defined “financial expert” in its Final Rule, Standards Relating to Listed Company Audit Committees (from April 2003 that can be found on the SEC’s website at www.sec.gov), as someone who has the following attributes: 1) an understanding of generally accepted accounting principles (GAAP) and financial statements; 2) an ability to assess the application of these principles in connection with accounting for estimates, accruals and reserves; 3) an understanding of audit committee functions; 4) experience preparing, auditing, analyzing or evaluating financial statements, or experience actively supervising persons engaged in such activities; and 5) an understanding of internal controls and procedures for financial reporting.
- ⁶ Audit Committee Effectiveness—What Works Best, prepared by PricewaterhouseCoopers and sponsored by the Institute of Internal Auditors Research Foundation, 2005 is available at www.theiia.org. The AICPA’s Audit Committee Toolkit for not-for-profits can be found in the AICPA’s website at www.aicpa.org in the “Audit Committee Effectiveness Center.”
- ⁷ Internal Control—Integrated Framework by COSO, July 1994 edition. The executive summary can be printed at no charge at www.coso.org.
- ⁸ Monitor the progress of SAS 60 at www.aicpa.org and monitor the actions of the GAO at www.gao.gov.

- ⁹ NACUBO Advisory Report 2003-3, The Sarbanes-Oxley Act of 2002: Recommendations for Higher Education, was published by NACUBO in November 2003, and is available to members of NACUBO at www.nacubo.org.
- ¹⁰ Final Report, the Panel on the Nonprofit Sector, page 80, available at www.nonprofitpanel.org.
- ¹¹ From NY bill A07579 at <http://assembly.state.ny.us/leg/?bn=A07579>. Note that in March 2006, the NY Attorney General (AG) posted proposed new regulations on this website (as opposed to legislative proposals) at <http://www.oag.state.ny.us/charities/charities.html> that interested readers might want to review.
- ¹² See the original proposed Massachusetts legislation, An Act to Promote the Financial Integrity of Public Charities, which is available at www.ago.state.ma.us.
- ¹³ For more information, visit www.whitehouse.gov/omb and look for OMB Circular A-21.
- ¹⁴ Under OMB Circular A-133, the auditee is required to submit a “Data Collection Form” with required data elements. A senior representative of the auditee must sign a statement that is included as part of the form. For more information, visit www.whitehouse.gov/omb.
- ¹⁵ From page 2 of the Executive Summary, Enterprise Risk Management—Integrated Framework, published by COSO in 2004 and available at COSO’s website at <http://www.coso.org>. The full report is available from the AICPA at www.cpa2biz.com in two volumes. The first volume includes the Executive Summary, as it has been posted on COSO’s website, and the more detailed Framework. The second volume, Application Techniques, provides implementation guidance.
- ¹⁶ From Frequently Asked Questions on COSO’s website at <http://www.coso.org>.
- ¹⁷ The July 2003 edition of the NACUBO Business Officer magazine (which is available at www.nabuco.org) featured an article about the University of Texas System’s compliance program. The University’s objective is to make compliance risk management an integral part of the everyday activities of all employees.

Acknowledgements

NACUBO and PricewaterhouseCoopers are grateful to the Sarbanes Summit participants for their thought-provoking commentary on the Sarbanes-related issues that colleges and universities are facing. We very much appreciate their time and attention.

We have tried to accurately capture the participants' observations in this paper. If we have not done so in any instance, we welcome corrections. We also welcome comments and other ideas about the issues raised in this paper from the higher education community.

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Molly C. Broad completed a nine-year service as president of the 16-campus University of North Carolina (UNC) in 2006. An economist, Broad came to UNC from the California State University system. She is currently on research leave in preparation for serving as Professor in the School of Government at Chapel Hill in 2007.

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