Grant Thornton
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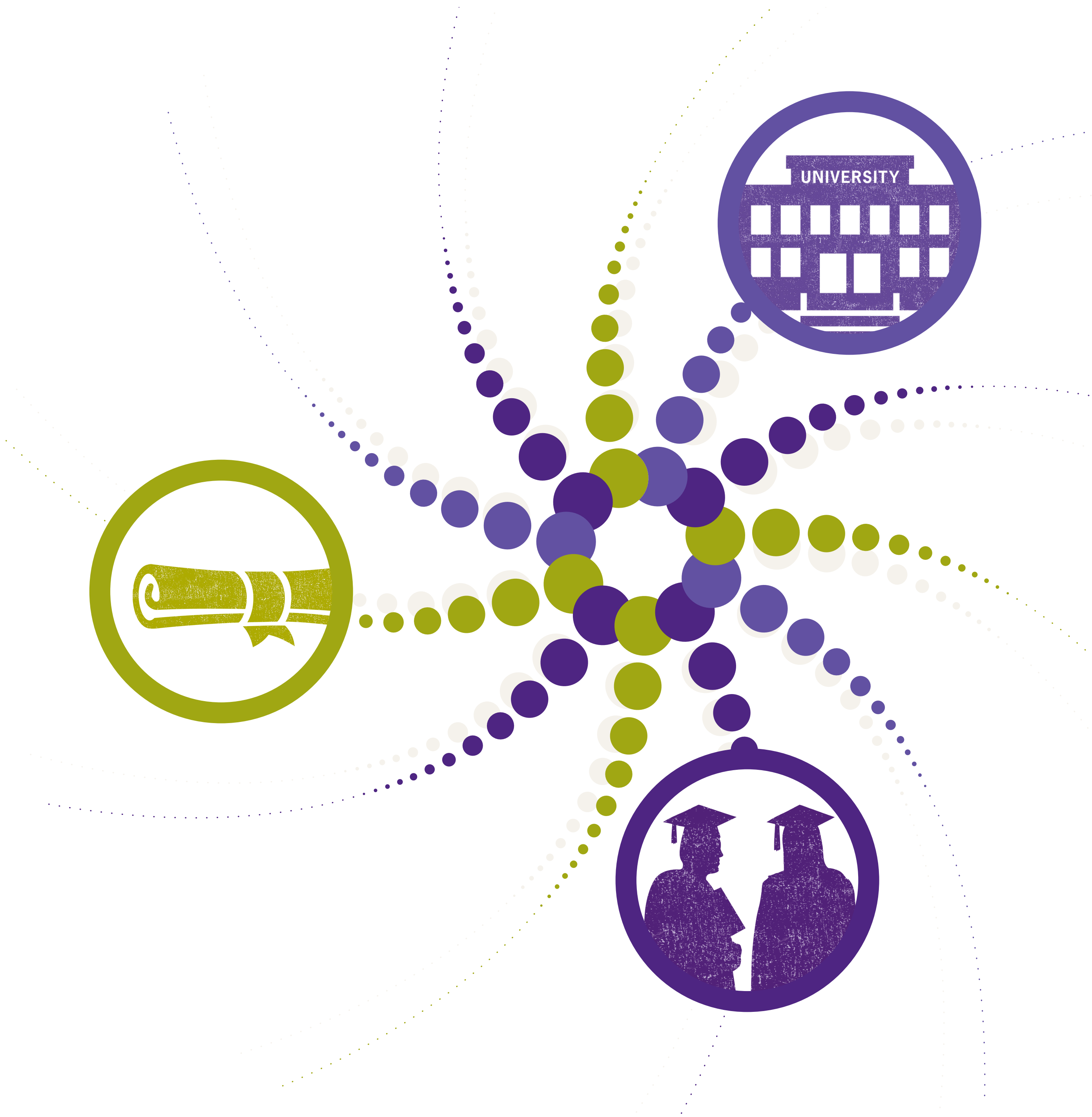
THIRD ANNUAL REPORT 2014

The state of higher education in 2014



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Introduction

Over the past eight years, our Higher Education and Not-for-Profit practices have grown to be among the largest in the country thanks to the talents and contributions of our professionals, and to the vision, passion and dedication of Frank Kurre. After nine years as our industry managing partner, Frank handed the reins of our industry practice to me as he took over as the office managing partner of our New York cluster. When Frank put together the first edition of *The state of higher education* report three years ago, his goal was to offer higher education executives and leaders down-to-earth, real-world guidance based on our professionals' deep knowledge of the industry. It is my honor and privilege to pick up where Frank left off and continue the great work of my friend and colleague.

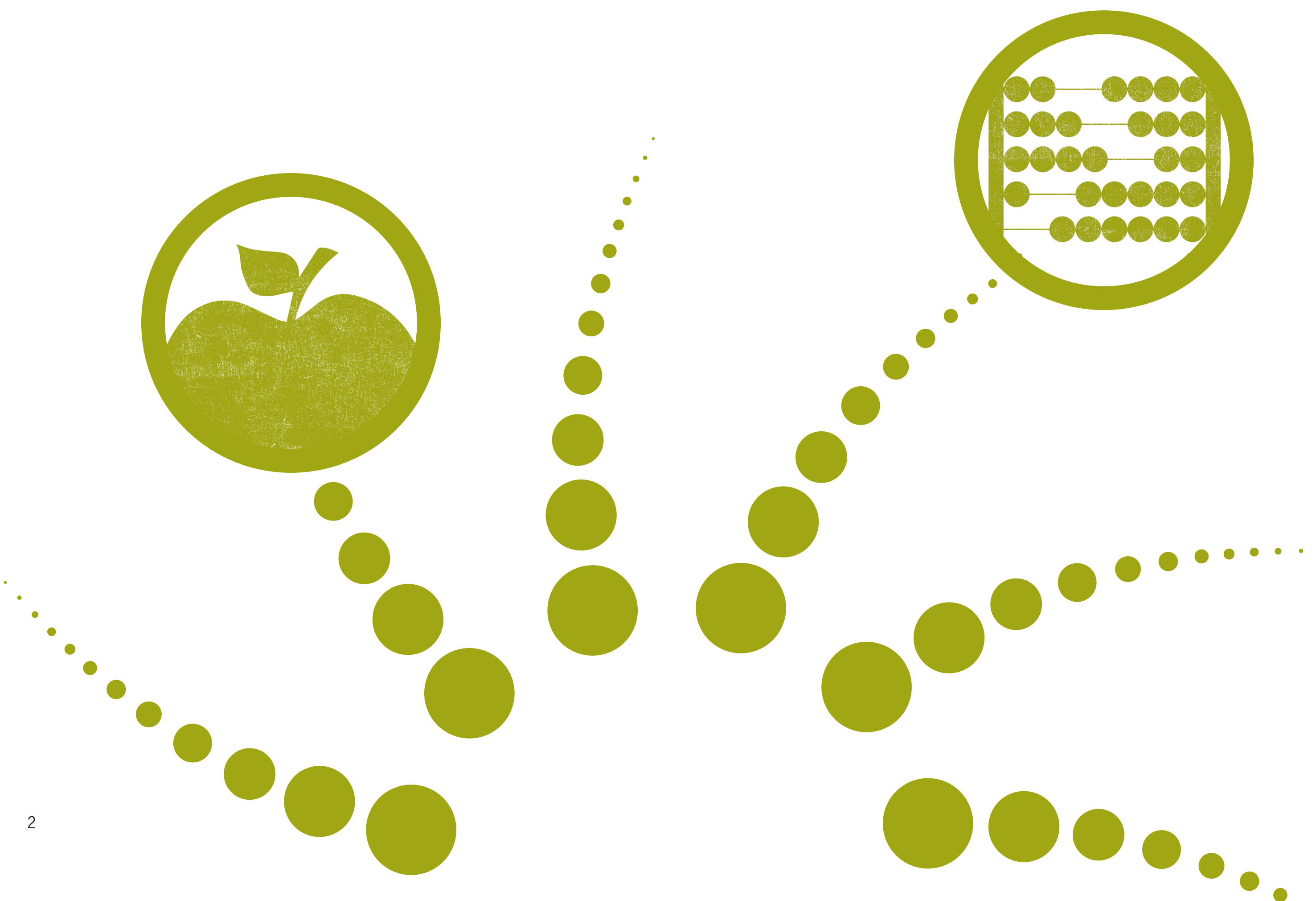
The higher education sector is one of our country's major employers and an invaluable source of ingenuity, innovation, research and workforce development. However, higher education is not immune to the same challenges and pressures facing other sectors — it struggles with revenue pressures, the quest for efficient operations and cost savings, and the impact of rapidly evolving technologies. Furthermore, the demographics of student bodies are changing and academic technology is presenting new opportunities and challenges; institutions need to adapt to meet the economic and learning needs of the next generation of students. This includes finding creative and sustainable ways of making education adaptable and affordable while attracting the right complement of students.

Our third annual report, *The state of higher education in 2014*, takes an in-depth look into some of the emerging strategies that the sector is beginning to adopt as it treads in unfamiliar waters. Enterprise risk management, effective board governance and online learning are gaining traction as university leaders realize that institutional challenges come in many shapes and sizes, and that protecting the institution's reputation is critical.

These are just a few examples of the trends that our Higher Education professionals have seen in their work over the past year and that we cover in this year's report. Whether you are a trustee, president, CFO, treasurer or chief audit executive, we hope that you find *The state of higher education in 2014* to be a valuable tool. As always, we welcome your feedback and are available to assist boards and management teams in addressing many of the challenges discussed in this report.

Sincerely,

Mark Oster
National Managing Partner,
Not-for-Profit and Higher Education Practices



Higher education struggles with low enrollment, risk management

Larry Ladd, Director, National Higher Education Practice

We are starting to see the first clues to big changes in higher education, and there are plenty of early warning signs: the flattening or reduction in net tuition revenue for many tuition-dependent private colleges, the lack of growth in federal research funding, and pressure to change the current ineffective governance models. There are hints at what the future might look like for many institutions as massive open online courses (MOOCs) adapt to both successes and failures, and some colleges experiment with tuition-pricing strategies to keep the sticker price unchanged or lower it. Even friends of higher education, such as President Obama, are showing tough love, insisting on new levels of transparency and accountability to maintain existing federal financial aid.

Resources are stretched to the limit

Colleges and universities receive revenue from net tuition, government support for financial aid, research and endowments (in some cases), and fundraising. Since 2008, all of these revenue sources have been under significant strain, despite some positive signs. Endowments are returning to a positive position, but are not as robust as they have been in the past. Fundraising remains weak except for the largest institutions[1, 2]. Government support has been highly uncertain, with the recent federal budget agreement assuring stability but no growth[3].

The credit rating agencies are discouraged by the financial condition of the higher education industry. In early 2013, Moody's reported that credit downgrades exceeded upgrades by 34-to-3. In December 2013, Moody's annual higher education outlook was negative for all sectors in the industry, citing, among other factors, "slowly growing revenue eclipsed by pressure to increase expenses."[4]

BY THE NUMBERS: LOW ENROLLMENT DRIVES TUITION DECLINE

- Undergraduate enrollments in 2012 were down at 46% of participating institutions, compared to the prior year.
- 50% of the CFOs at institutions with declining enrollments "attribute the drop to price sensitivity."
- The discount rate for entering freshmen reached an all-time high of 44.3%.
- 34.6% of institutions report further reducing or holding steady the discount rate.

Source: National Association of College and University Business Officers. "2012 Tuition Discounting Study." See www.nacubo.org/Research/Research_News/The_2012_Tuition_Discounting_Study_Has_Been_Released.html

46%
DOWN IN UNDERGRADUATE ENROLLMENTS

1 Troop, Don. "Gifts to U.S. Colleges Rose 2.3% in 2012, Narrowly Outpacing Inflation," *The Chronicle of Higher Education*, Feb. 20, 2013. See http://chronicle.com/article/Gifts-to-US-Colleges-Rose/137409/.
2 Council for Aid to Education. "Colleges and Universities Raise $31 Billion in 2012" (press release), Feb. 20, 2013. See http://cae.org/images/uploads/pdf/VSE-2012-Press-Release.pdf.
3 Lewin, Tamar. "Financing for Colleges Declines as Costs Rise," *The New York Times*, March 6, 2013. See www.nytimes.com/2013/03/06/education/aid-for-higher-education-declines-as-costs-rise.html.
4 Moody's Investors Service. "Moody's: Outlook for U.S. Higher Education Sector Remains Negative for 2014," Nov. 25, 2013. See www.moodys.com/research/Moodys-Outlook-for-US-higher-education-sector-remains-negative-for–PR_287582.

For tuition-dependent private colleges and universities, net tuition revenue is obviously the biggest revenue risk. Moody's reports that many colleges are experiencing flat or declining net tuition revenue, indicating a new level of price sensitivity among parents and students[5]. A growing number of tuition-dependent colleges, especially those with significant tuition discounting, are announcing no tuition increases or actual reductions in the formal sticker price. Both the *The Wall Street Journal* and *The New York Times* have published articles outlining the enrollment — and thus financial — challenges facing mid-tier tuition-dependent colleges and universities[6,7].

A recent Moody's survey provides the first solid evidence that tuition payers are beginning to have reservations about the cost-value proposition offered by many higher education institutions. If those reservations translate into significant enrollment declines at the colleges and universities that rely primarily on tuition, those institutions will be in big trouble[8].

For research universities — public and private — federal research funding has been severely strained, and as a result, alternative sources of support have become essential to future growth. Sequestration caused belt-tightening and raised fears about long-term commitment from the government[9]. While the recent budget agreement created stability, it didn't create more dollars.

Technology is here to stay

The digital revolution is changing all aspects of culture and economic life, including higher education. Colleges and universities that embrace the revolution, with all of its ups and downs, are far more likely to be successful.

Technology continues to transform the methods by which students learn. Most importantly, the Internet is creating an entirely new level of access to faculty talent and information, along with a growing set of tools for effective engagement in the learning process — a longtime challenge. The advantages of place and time, which have been particularly important for regional colleges and universities, are fading away.

Three-quarters of college and university trustees now recognize that online learning will be important or even essential to their institutions within the next five years[10].

[5] Moody's Investor Service. "Moody's: Outlook for U.S. Higher Education Sector Remains Negative for 2014," Nov. 25, 2013. See www.moodys.com/research/Moodys-Outlook-for-US-higher-education-sector-remains-negative-for–PR_287582.

[6] Belkin, Douglas, and McWhirter, Cameron. "Student Drought Hits Smaller Universities," *The Wall Street Journal*, July 25, 2013. See http://online.wsj.com/news/articles/SB100014241278873239712045786282306546531 80.

[7] Pena-Perez, Richard. "College Enrollment Falls as Economy Recovers," *The New York Times*, July 25, 2013. See www.nytimes.com/2013/07/26/education/in-a-recovering-economy-a-decline-in-college-enrollment.html.

[8] Belkin, Douglas. "Tuition Crunch Takes Big Toll," *The Wall Street Journal*, Nov. 22, 2013. See http://online.wsj.com/news/articles/SB10001424052702304607104579212420716860930.

[9] Bidwell, Allie. "Sequestration Presents Uncertain Outlook for Students, Researchers, and Job-Seekers," *The Chronicle of Higher Education*, March 1, 2013. See http://chronicle.com/article/Sequestration-Presents/137617.

[10] Association of Governing Boards. "2013 Survey on Technology and Instruction: Taking the Board to School on Educational Technology." See http://agb.org/sites/agb.org/files/report_2013_technology_survey.pdf.

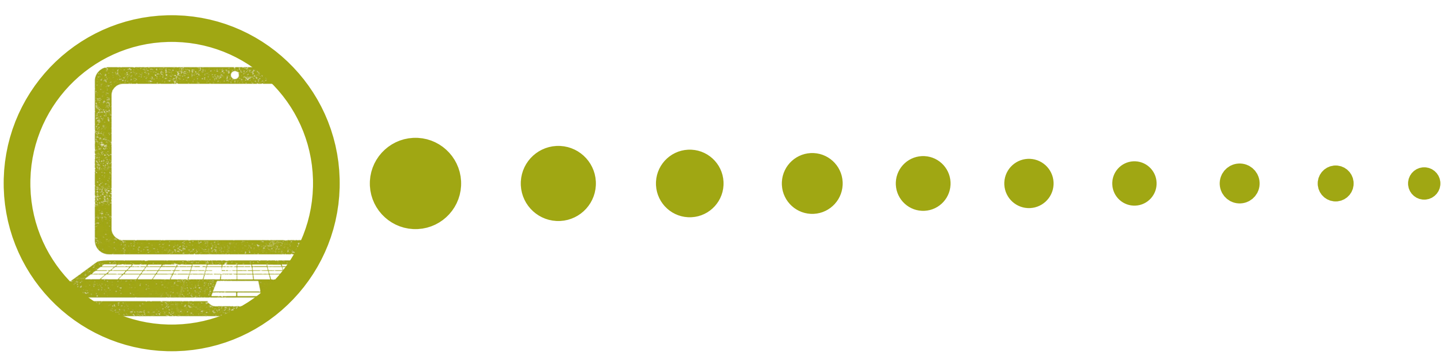
However, a survey of 841 college and university presidents showed that they are very conservative in their views about their colleges and the higher education industry[11]. They do not see a crisis in higher education, and expect to only make modest budget adjustments or encourage some interinstitutional collaboration. They also are skeptical of innovations such as MOOCs.

2013 was the year it became clear that MOOCs won't just transform the learning process, but will gradually become an integral part of that process in some form not yet fully known[12]. Online courses continued to proliferate, largely because they increase accessibility and reduce costs. Hybrid and "flipped" courses, both of which combine online and in-person learning, became increasingly popular. A very promising master's degree program announced by the Georgia Institute of Technology may indicate one future path. Even former Princeton President Bill Bowen, a traditionalist, has written a book that is optimistic about the impact of technology[13].

Steadfast leadership is critical

In a time of rapid change, every institution faces enormous risk and opportunity, and inaction is much riskier than a wait-and-see approach. Be prepared though: Action will generate controversy, because most constituencies support the status quo and believe that the institution they love is immune to the changes occurring in the broader culture.

Leadership must assess the school's current condition and the changes in the larger landscape that are likely to change the competitive environment. It will be important to determine whether your institution can continue on its current course while still surviving and thriving. For most institutions, the current course is not sustainable. It will then be necessary to try new ideas and take risks, knowing that some of the ideas will fail, but that some will also succeed and lead to a renewal of the institution's mission by different means.



[11] Lederman, Doug. "Affirmative Action, Innovation and the Financial Future: A Survey of Presidents," *Inside Higher Ed,* March 1, 2013. See www.insidehighered.com/news/survey/affirmative-action-innovation-and-financial-future-survey-presidents.

[12] Friedman, Thomas L. "The Professors' Big Stage," *The New York Times*, March 5, 2013. See www.nytimes.com/2013/03/06/opinion/friedman-the-professors-big-stage.html.

[13] Rivard, Ry. "Online Rx for 'Cost Disease,'" *Inside Higher Ed,* March 29, 2013. See www.insidehighered.com/news/2013/03/29/bill-bowens-new-book-moocs-and-online-education.

7 WAYS TO PREVENT NONFINANCIAL DATA FRAUD

1. Place nonfinancial information high on the risk profile so that it receives the necessary attention from senior officers and the audit committee.

2. Incorporate the reporting of nonfinancial information into your institution's code of conduct and whistleblower procedures.

3. Create an inventory of nonfinancial information, including an assessment of each item's relative importance to the institution and the potential impact if such information was found to be inaccurate or misleading.

4. Establish trustee policies about the information to be shared regularly with board members and committees. Audit committees, for instance, see IRS Form 990 returns but probably not other information regularly reported to the government and other agencies.

5. Establish internal controls regarding the production of nonfinancial information ranked high in the inventory.

6. Regularly test the effectiveness of the internal controls through random internal audits, either by the internal audit department or a third party. Annually report the results of those tests to the audit committee.

7. Establish a process for handling allegations of inaccurate or misleading information that includes the use of outside counsel to conduct an independent investigation, as well as public disclosure of the allegations and their resolution.

Other trends worth noting

Risk management. Colleges and universities are increasingly adopting enterprise risk management (ERM) as a tool for identifying and mitigating key risks faced by the institution. Standard & Poor's has stated explicitly that the presence of an ERM program is part of its rating evaluation[14].

Nonfinancial reporting fraud. This issue remains on the radar screen, as colleges and universities continue to discover that their reporting to *U.S. News & World Report* and other external groups has contained errors or misstatements of fact. As a result, internal controls over nonfinancial reporting are being reviewed and strengthened. The National Association for College Admission Counseling has issued a new regulation stating that colleges must have "an official policy regarding the collection, calculation and reporting on institutional statistics. This must include a process for validating all institution data."[15]

Improving operating performance. Most colleges and universities are looking particularly at their nonacademic administrative services to create efficiencies and, in some cases, eliminate services to achieve operational cost reductions. The concept of shared services is gaining popularity. So is rethinking all back-office operations. As the president of the University of Texas at Austin said, "Universities are not simply businesses, but in some ways they are like businesses — processing applications, supporting information technology, reimbursing travel, buying paper from outside vendors, turning lights on and off, printing and mailing, and so forth. In these areas, they ought to be following the best business practices."[16]

Governance. This remains a top concern, with the Association of Governing Boards (AGB) announcing the formation of the National Commission on College and University Board Governance to recommend best practices in light of recent governance challenges at such institutions as the University of Virginia and Pennsylvania State University. The AGB has also issued an updated statement on conflicts of interest that aims to guide and inform boards, as well as clarify their relationships with leadership, administration and faculty[17].

[14] Enterprise Risk Management Initiative. "S&P Evaluations of ERM as Part of Credit Rating Process," Feb. 27, 2009. See http://erm.ncsu.edu/library/article/steve-dreyer-roundtable#.Uu-3brR_uxs.
[15] Jaschik, Scott. "Validation Required," *Inside Higher Ed*, Sept. 23, 2013. See www.insidehighered.com/news/2013/09/23/admissions-association-will-require-validation-rankings-statistics.
[16] Powers, Bill. "Smarter Systems for a Greater UT Speech," University of Texas at Austin. See www.utexas.edu/transforming-ut/resources/smarter-systems-speech.
[17] Association of Governing Boards. "AGB Board of Directors' Statement on Conflict of Interest with Guidelines on Compelling Benefit." See http://agb.org/sites/agb.org/files/u3/statement_2013_conflict_of_interest.pdf.

Revenue challenges: Should you plan for the short term or the long haul?

Mary Foster, Managing Director, Not-for-Profit and Higher Education Practices

Revenue woes for colleges and universities continue to plague presidents, administrators and boards. Nationwide, enrollments are declining. Student support needs are at an all-time high. Endowment returns are uncertain. Competition for students from both brick-and-mortar and online universities is fierce. How are leading institutions grappling with these revenue challenges?

The short answer: There is no single textbook response. Strategies vary depending on how long the revenue strain is expected to last. There is ample debate about whether the current top-line tuition revenue disruption represents a cyclical hiccup or the new normal. Depending on the institution's view, strategies will differ.

First, determine a viewpoint

The first requirement for boards and management is to reach a consensus about this question: Will revenue from tuition, grants, private support and investments return in short order? If not, how does this affect the institution's strategic plan? Whichever side the institution comes down on — revenue pressures considered a short-term concern or a lasting issue — ripples will carry through decision-making and strategic planning.

For example, enrollment of traditional college-age students will decrease as part of the nation's changing demographics. Assuming the institution will be impacted by the enrollment change, leadership's strategy should reflect its view on the permanency of the enrollment change. If a tuition revenue drop is expected due to decreased enrollment, does leadership view this as a trend that will eventually reverse?

Strategies to manage a period of lowered tuition revenue usually entail cost cutting. Periods of higher student discounts can be used to maintain or grow gross tuition revenue, but during those periods, discounts must be supported by the endowment. If this is viewed as a five-year anomaly, the approach works. On the other hand, if leaders believe tuition revenue won't bounce back, they need a longer-term strategy for sustainability.

If the revenue strain is perceived to be permanent, an institution must consider how it will adjust its approach on a permanent basis going forward – i.e., how to continue delivering high-quality services in a cost-effective manner without unduly impacting endowment assets. The institution will need to reconcile its priorities — support for students, academic programs and facilities, financial investments — with where it thinks long-term revenue is going. If the board and management haven't started by articulating a point of view, the institution's financial plan could become misaligned with its strategic goals and financial results.

Tailor solutions to the type of institution

Colleges and universities are pursuing a range of ways to deal with potential revenue challenges. For some, partnerships and collaborations with other colleges — dual-degree programs — are a way to expand or sustain curriculum offerings while minimizing costs. So are partnerships with local corporations, which can involve offerings such as internships, externships and research fellowships for undergraduate and graduate students, or on-site college classes for targeted groups of employees.

The appropriate solutions depend somewhat on the type of institution and its location and programs. Research universities have unique opportunities to monetize intellectual property and pursue patents, but they also have the challenge of sustaining consistent levels of federal research funding to support faculty and graduate students. Universities have been absorbing increasing amounts of the costs of federally sponsored research. If this is viewed as a permanent shift of costs from the government to the institution, short- and long-term financial plans need to clarify the research strategy.

Listing strengths, weaknesses will clarify strategy

Leadership will want to consider a number of questions as they contend with these challenges and set a strategy for their institution, depending on how long they think the issue will last.

Enrollment

- What is the optimum level for our enrollment?
- What are the strategies we need to adopt to support our optimum enrollment level?
- What are the costs of the optimum enrollment level in terms of headcount, payment ability and faculty-to-student ratios?
- Are we hitting our desired metrics, and is it becoming more costly to do so? How do we address this challenge?

Pricing

- What are our discounting and pricing strategies, given the competitive pricing market?

Academic programs

- How does management measure the competitiveness of our academic programs relative to other institutions — peer and aspirant?
- Are we offering the interdisciplinary curricula demanded by students?
- Are there new opportunities for collaboration across disciplines or with regional partners?
- Are we offering the correct balance of critical thinking and workforce-/professional-readiness programs?
- Do our programs prepare students for success in a job market that seeks skills in the science, technology, engineering and math fields?

Demographics

- How do we expect demographic shifts to affect our existing programs?
- What are we doing to position ourselves for the future?

Corporate partnerships

- What is our strategy for corporate partnerships?
- Who are the major employers of our students?
- Do we have business or research partners who can provide opportunities for students, protect tuition revenue and provide financial support to key programs?
- Can we look to either major benefactors for significant gifts or to more partnerships with corporations?

R&D

- What kind of intellectual property revenue are we deriving from our R&D?
- How can we increase the speed by which we commercialize and monetize our patents and ideas?
- Given federal cuts in research spending and the increased support required from universities, how do we adapt our R&D plans?
- Do we have an economic development officer? If not, do we need one?

Facilities

- How are we maintaining a competitive environment in terms of classroom and faculty technologies, as well as student and campus life?
- If we're spending on facilities, are there other investments that we should be forgoing?

Noncore assets

- What noncore assets can be a source of revenue?
- How can we monetize our facilities (i.e., through sales and lease-back arrangements or through generation of alternative income)? For example, should we lease or sell an underutilized university-owned parcel of land? Can we rent out dorms or athletic facilities when the space is not being utilized?

Today's concerns, tomorrow's issues need long-term planning

If revenue continues to be challenged for the foreseeable future, higher education institutions will need to strategically re-examine their investments and be especially careful about the kinds of debt they take on. No college or university wants to be in the position of having to gut a treasured academic program. At the same time, the unfortunate reality is that most colleges and universities must be prepared to make trade-offs.

There are no easy answers. Boards and management need to stay focused on the big picture and ask tough questions — not just about short-term solutions to generate revenue, but also about the institution's long-term strategic initiatives.

Tips for advancing an effective ERM program at your institution

Paul Klein, Managing Director, Business Advisory Services
Mark Oster, National Managing Partner, Not-for-Profit and Higher Education Practices

Strong enterprise risk management (ERM) programs can give colleges and universities the edge they need to remain competitive and attractive to students, faculty and staff. Not only do colleges face the perennial challenges of maintaining compelling academic programs, campus safety and emergency preparedness, but also new and evolving concerns, such as shrinking traditional student populations, a changing regulatory and reporting landscape (e.g., President Obama's so-called "college scorecard"), and verifying the identities of online students.

Successful ERM implementation can help colleges identify high-risk areas, develop appropriate mitigation strategies, protect their assets and interests, and remove the barriers to achieving their strategic goals. This article is based on lessons learned from Grant Thornton's real-world experience helping our higher education clients implement their ERM programs.

Yet, even as interest in ERM within higher education grows, ERM implementation remains nascent. In contrast, many large corporations and public companies have already embraced ERM: 45% of public companies report having a complete ERM program in place. Merely 12% of not-for-profits (including higher education institutions) claim the same, and only 25% report putting forth any effort to implement a program, according to a 2012 AICPA report on enterprise risk oversight across a range of industries[1]. Such a disparity leaves senior leadership at colleges and universities wondering what it will take to instill ERM in their institution.

5 stages of ERM adoption

While ERM initiatives can look quite different from one school to the next, there are essentially five stages of ERM adoption. It is important to note that one stage is not inherently better or worse than another. Rather, one stage may be more appropriate for a particular institution depending on the school's long-term goals, constituent needs, available resources and other relevant factors.

1. Ad hoc
2. Initial
3. Formalized
4. Embedded
5. Optimized

[1] Beasley, Mark; Branson, Bruce; and Hancock, Bonnie. "Current State of Enterprise Risk Oversight: Progress Is Occurring but Opportunities for Improvement Remain," July 2012. See www.aicpa.org/interestareas/businessindustryandgovernment/resources/erm/downloadabledocuments/aicpa_erm_research_study_2012.pdf.

As schools move from ERM interest to implementation, they experience different challenges based on the maturity of their program.

1. Ad hoc

In the ad hoc stage, risk management is largely driven by the efforts of individuals, typically those in management whose primary role is to manage risks (e.g., finance, insurance, internal audit). At many institutions, this is where ERM efforts begin.

2. Initial

In the initial stage of ERM implementation, the organization has established a framework, shared language and understanding of what constitutes ERM, but it's still new and relatively untested. ERM processes have been established in the parts of the organization that are considered most vulnerable to risk. The tone from the top is likely targeting senior-level management or a specific department to pilot an ERM initiative.

Ad hoc at a glance

Characteristics

- Growing awareness of strategic risks requiring cross-disciplinary attention.
- Risk management is largely driven by individual efforts.
- Lack of a common language to describe and evaluate risks.

Common challenges

- Setting the tone from the top about risks.
- Developing a common language for discussing risks.
- Developing a common framework for evaluating risks.
- Identifying the top-tier risks that pose a threat to the institution.

Initial stage at a glance

Characteristics

- ERM is becoming a part of the institutional consciousness.
- ERM processes may only exist at a specific level of the organization, such as the senior cabinet or a department to pilot ERM activities.

Common challenges

- Extending ERM into a more consistent and established process, with specific policies and procedures.
- Communicating what ERM is and how it works within the institution more broadly.

3. Formalized

In this stage, the organization has established consistent ERM processes for senior leadership. Discussions about enterprise risks are regular agenda items at senior cabinet and trustee meetings. The organization has established standard ERM work products — risk registers, in which risk events are assessed and analyzed — and action item planning and tracking. ERM disciplines are starting to filter down to administrative and academic departments.

4. Embedded

When ERM processes are embedded, risk conversations are integrated into business planning at all levels. Staff and faculty throughout the institution — from the president to work study students — are aware of potential risks and take responsibility for minimizing exposure. Individual and group responsibilities for managing risks are well understood. When employees encounter a potential risk, they report it, even if it's not technically within their job description. Throughout the institution, action items to mitigate risks are clearly documented and managed.

Formalized stage at a glance

Characteristics

- Common language and framework exist.
- Policies and procedures related to risk are in place.
- Risk discussions are regular agenda items at meetings.
- ERM disciplines are starting to filter down to administrative and academic departments.

Common challenges

- Broadening understanding of risk throughout the organization.
- Introducing ERM concepts and processes deeper in the organization.
- Spreading the message about the importance of participating in and propagating a risk-aware culture.

Embedded stage at a glance

Characteristics

- Employees at all levels of the organization understand the value the institution places on risk management.
- Individual and group responsibilities for identifying, reporting and acting on risks are well understood.
- Organizations track and manage risk action items.

Common challenges

- Considering how ERM can become a competitive advantage for the organization.
- Incorporating risk discussions when evaluating new opportunities.

5. Optimized

At this stage, institutions leverage their ERM program as a source of competitive advantage. They embrace a holistic view of risk. Management considers all decisions — such as which programs to add or cut, or which new opportunities to pursue — in the context of potential risks and the organization's risk appetite. They not only focus on achieving internal improvements, but look to other organizations, both within the industry and beyond, to learn what others are worried about and what works.

Optimized stage at a glance

Characteristics

- Management and trustees consider all decisions and new opportunities in the context of potential risks.
- The institution learns from the successes and challenges of others.

Common challenges

- Championing ERM successes.
- Sharing best practices with other institutions.

Take your ERM program to the next level

ERM programs have proven to be extremely beneficial to colleges and universities. Leaders who aren't taking full advantage of ERM to monitor and manage risks need to consider taking their program to the next level.

OVERCOMING COMMON ERM BARRIERS

Following are a number of reasons ERM has stalled in higher education and how to overcome them:

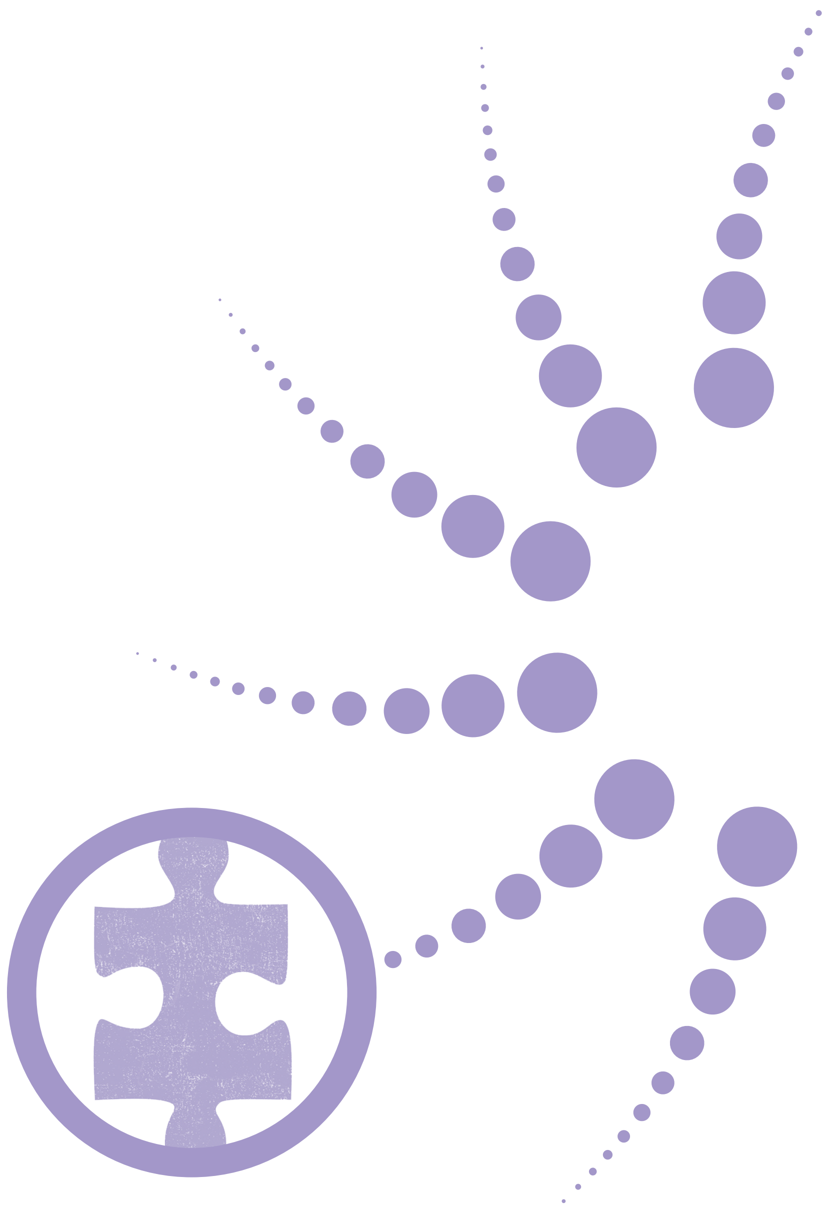
1. The corporate ERM model doesn't work in higher education. ERM is much more advanced among public companies. Their "command and control" model supports adoption when leadership mandates it. Higher education's decentralized business model requires more finesse to gain buy-in and participation. The ERM implementation methodology we have developed is helping a growing number of institutions overcome these unique challenges and engage both the academic and administrative sides of the organization.
2. ERM efforts lack senior-level support. ERM may be adopted by departmental leadership but lack a strong buy-in from the top. To succeed, ERM needs to cross functional boundaries, so it is imperative for senior leadership to model the new behaviors to reinforce the cultural changes needed to embed ERM practices in the organization.
3. Inappropriate selection of ERM "shepherd." If the program leader is in internal audit, ERM may be viewed as a controls and compliance function. If the controller leads it, risk discussions may tend to focus on finances. It is important to get the right person at the helm — someone who has the respect of the full organization. In order to invest ERM with the appropriate level of gravitas, it is important to have a leader backed by a cross-functional senior team, with clear and active support from the president.

How higher education is adapting to change: 3 emerging strategies

Susana Lee, Senior Associate, Not-for-Profit and Higher Education Practices, Business Advisory Services
Joseph Mulligan, Manager, Not-for-Profit and Higher Education Practices, Business Advisory Services
Mark Oster, National Managing Partner, Not-for-Profit and Higher Education Practices

"A host of struggling colleges and universities — the bottom 25% of every tier, we predict — will disappear or merge in the next 10 to 15 years." This is the forecast of Harvard Professor Clayton Christensen and think tank leader Michael Horn in a *New York Times* essay from late 2013[1]. While Christensen and Horn's prediction may seem alarmist, it reflects the sense of urgency felt by many in the higher education sector.

As markets, technology and stakeholder needs continue to change rapidly, college and university leaders are searching for new ways to adapt. Some have drawn from practices traditionally found in the private sector, such as mergers and joint ventures, in order to strengthen their existing services. Others have pursued strategic partnerships and collaborations with organizations in other sectors in an effort to change or enhance their existing service delivery models. Although these solutions may not be a good fit for every school, they provide valuable lessons to higher education leaders, who must continually assess their institutions' objectives and capabilities to keep up with change.



[1] Christensen, Clayton, and Horn, Michael B. "Innovation Imperative: Change Everything," *The New York Times*, Nov. 1, 2013. See www.nytimes.com/2013/11/03/education/edlife/online-education-as-an-agent-of-transformation.html?_r=0.

1. Growth through strategic mergers

Common growth objectives for universities include developing new programmatic initiatives, increasing revenue streams from new markets, and building regional or national brand recognition. The July 2013 merger between Rutgers University, The State University of New Jersey and the University of Medicine and Dentistry of New Jersey (UMDNJ) aimed to achieve all of these goals. The union is the largest higher education merger in U.S. history and brought seven out of eight UMDNJ schools into the Rutgers system. The new institution has a combined annual budget of approximately $3.7 billion and ranks among the top 25 U.S. universities in research spending[2].

State legislators, the board of regents and other supporters are hopeful that the merger will enable Rutgers to capture additional federal research grants and attract top faculty members and students from all disciplines. As with any major strategic pursuit, Rutgers had to spend significant resources before reaping the benefits: One-time merger costs were estimated to be approximately $75 million. Hundreds of employees served on integration teams, executing a checklist of over 4,600 merger-related tasks. In addition, university leaders and legislators spent months planning and communicating details of the deal to the Rutgers community. Moving forward, effective financial and strategic planning, as well as active stakeholder engagement, will continue to be essential for the university.

2. Efficiency through consolidation

In addition to pursuing top-line growth, many U.S. universities are considering various cost-containment and efficiency measures to remain competitive. Consolidation of existing schools and programs is one such approach. In a 2011 report to the Georgia Board of Regents, University System of Georgia (USG) Chancellor Hank Huckaby spoke of the need for higher education leaders to proactively embrace change in order to improve performance and outcomes[3]. The board of regents subsequently approved six principles to be used in assessing potential consolidations that could cut costs and increase efficiency and effectiveness.

By 2013, USG had consolidated eight of its public institutions into four. One of these newly formed institutions, Georgia Regents University, was able to cut administrative costs by 3% in its first few weeks[4]. In addition, USG is pursuing similar measures at its other schools, and recently approved a merger between Kennesaw State University and Southern Polytechnic State University with the hopes of achieving comparable results.

[2] Heyboer, Kelly. "Welcome to the new Rutgers: School makes history with UMDNJ merger," NJ.com, June 30, 2013. See www.nj.com/news/index.ssf/2013/06/welcome_to_the_new_rutgers_university_makes_history_with_umdnj_merger.html.

[3] Huckaby, Hank. "Report to the Board of Regents," University System of Georgia, Sept. 14, 2011. See http://www.usg.edu/chancellor/speeches/chancellor_huckabys_report_to_the_board_of_regentswww.usg.edu/chancellor/speeches/chancellor_huckabys_report_to_the_board_of_regents.

[4] Marcus, Jon. "Cash-Strapped Universities Turn to Corporate-Style Consolidation," *Time*, July 19, 2013. See http://nation.time.com/2013/07/19/cash-strapped-universities-turn-to-corporate-style-consolidation/.

3. Expanding presence and influence through alternative go-to-market strategies

Colleges and universities continue to respond to change while employing a more market-centric approach. It was not long ago when higher education institutions required nearly all students to make the pilgrimage to one traditional brick-and-mortar campus to have an enriching academic experience. Courses were offered on a fixed schedule and in a single format.

In recent decades, many institutions have established one or more satellite campuses within their immediate geography or in strategic international locations to expand influence and better serve their mission. Boston-based Northeastern University has recently embarked on a much more ambitious undertaking to achieve such objectives. After surveying the U.S. higher education landscape and identifying markets that they felt were underserved by existing providers, Northeastern's leadership were willing to break the mold and expand the university's influence and footprint nationally. After studying employer needs and student demand in select markets, and coordinating efforts with local city officials for more than two years, Northeastern debuted a graduate campus in Charlotte, N.C., in 2011, and another outpost in Seattle in 2013. Building on the recent success of these initiatives, the university is now planning branch campuses in other regions, including the Southwest, Midwest and Silicon Valley.

Similarly, technological advancements have prompted other institutions to consider alternative service delivery models. In 2012, Stanford University, Princeton University, the University of Michigan and the University of Pennsylvania partnered with Coursera, a massive open online course (MOOC) platform that seeks to increase access to education. Harvard University and the Massachusetts Institute of Technology joined forces the same year to start a MOOC provider of their own, edX. As of early 2014, more than 130 institutions were actively engaged with MOOC providers.

In addition to making educational content available to the masses, MOOC platforms have enabled participating institutions to generate additional revenue; build their brand and reputational goodwill; conduct new research on learning and distance education; and study retention, course completion and learning outcomes. While scholars and industry observers are still trying to determine whether these platforms are a temporary sensation or a permanent game changer, MOOCs clearly have the potential to be a disruptive force in the higher education industry.

These examples illustrate how higher education institutions are clearly acknowledging that they will be focused on serving students when, where and how they'd like to consume education.

Adapting to change: A question of when, not if

Responding to change requires deliberate strategic and financial planning and significant institutional commitment. University leaders face many of the same challenges that commercial entities are confronted with, and expectations to respond with unprecedented action are higher than ever. As in the for-profit space, the financial benefits and synergies expected from a merger or partnership may not materialize. Organizational fit can also become an issue if the two partners have very different values and cultures. This risk is especially high when the institution is operating in new markets or unfamiliar regulatory environments (e.g., expanding internationally).

In addition, even endeavors that have the potential to be financially lucrative and offer other positive benefits could become the subject of criticism by some constituents. Key stakeholders, such as faculty members and alumni, might resist an institution's planned changes. For instance, buy-in might be difficult to achieve if they think that a partnership would diminish the institution's rich tradition, their expectations are not managed, or their input is not sought during the planning and execution phases.

Despite all these challenges, higher education leaders cannot afford to become victims of change or rely exclusively on traditional, organic growth. Proactive leadership and ongoing innovation and creativity will be required for institutional success in 2014 and beyond.

How student demographics are changing higher education

Larry Ladd, Director, National Higher Education Practice

Students are rapidly changing the constituencies of most colleges and universities, and the pace is picking up. Higher education institutions, especially the admissions departments, need to take note of the changes and thoughtfully plan their responses.

Overall number of high school graduates is decreasing

Higher education has largely oriented itself to a continuous climb in the number of high school graduates, but that long-time trend is about to end. Because of the decreasing national youth population, the total number of high school graduates will decline over the next half-generation, from 3.39 million in 2009–2010 to 3.25 million in 2027–2028[1]. Besides the lowering of the applicant pool, the majority of colleges and universities — those that traditionally rely on enrollment from their own geographic area — will feel dramatic impacts by region.

In the Northeast, the decline will be 11%; in the Midwest, it will be 12%. The West will remain constant, while the South — the one region that will grow — will enjoy 5% more applicants[2]. If your school draws heavily from the Northeast and/or Midwest, you'll want to start appealing to students from farther away.

It's important to know who — and how many

The makeup of the national high school population is shifting along with the numbers. Race and ethnicity are moving from a white student of European ancestry to a wider array of colors and backgrounds. Income levels, too, are becoming more mixed. "Projecting enrollments outward suggests that white non-Hispanics will no longer be the majority in our nation's public high schools by 2020–21."[3] This is according to the Western Interstate Commission for Higher Education, a regional organization that works to improve access to higher education.

The U.S. Census Bureau agrees. In its annual school enrollment report, released Sept. 3, 2013, the bureau reports that the proportion of native-born students is dropping and that of white students is dropping quickly[4].

The report also contains these observations:

- We remain a nation of immigrants. In 2012, foreign-born students or students whose parents were born outside the United States made up about one-third of all students from preschool through college.

- College enrollment overall is becoming more racially diverse. The national percentage of Hispanic college students rose from 11% to 17% between 2006 and 2012. The number of black students rose slightly, from 14% to 15%, while the number of non-Hispanic white students went down, from 67% to 58%.

In 2012, Latinos outnumbered all others in applications to the University of California for the first time[5].

[1] Western Interstate Commission for Higher Education. "Knocking at the College Door: Projections of High School Graduates," December 2012. See www.wiche.edu/knocking-8th.
[2] *Ibid.*
[3] *Ibid.*
[4] U.S. Census Bureau. "After a Recent Upswing, College Enrollment Declines, Census Bureau Reports" (press release), Sept. 3, 2013. See www.census.gov/newsroom/releases/archives/education/cb13-153.html.
[5] Flores, Adolfo. "UC Freshman Applicants for 2013 a Record High," *Los Angeles Times*, Jan. 18, 2013. See http://articles.latimes.com/2013/jan/18/local/la-me-uc-applicants-20130119.

The numbers of low-income students are changing, as well. Half of low-income high school graduates were college students in 2012, up from one-third in the 1980s[6]. The cost of higher education is a common concern; for students in a lower-income bracket, decisions about what college to choose and how to earn a degree in four years are even more dependent on tuition prices and discounts offered.

With these figures in mind, your college or university needs to envision its future students as coming primarily from Hispanic, black, Asian/Pacific Islander and American Indian/Alaska Native populations, with an increasing number from lower-income households.

Plan for a diverse future

Changes in high school and other populations are bringing changes in higher education populations. Successful institutions will study these changes, anticipate them and adjust their sights accordingly.

Appealing to the new, diverse range of students is an academic and financial necessity. To meet the needs of their students and to provide for strong enrollments and sustainable finances, higher education institutions must design strategic plans for appropriate programs and approaches to recruitment and admissions, learning, language and culture.

NON-HIGH SCHOOL-RELATED CONSIDERATIONS

- Postsecondary enrollment of adults ages 25 and older is projected to grow by 25.4% between fall 2008 and fall 2019[7].
- With continued economic and other pressures, a contingency of students will continue to opt for part-time enrollment.
- For some of the same reasons, the number of students who choose to take credited online courses is on the rise. In the past few years the rate has been slower, but online classes are still growing faster than higher institutions' enrollment overall[8].

25.4%

GROWTH IN POSTSECONDARY ENROLLMENTS OF 25 AND OLDER

[6] DeSilver, Drew. "College Enrollment Among Low-Income Students Still Trails Richer Groups," Pew Research Center, Jan. 15, 2014. See www.pewresearch.org/fact-tank/2014/01/15/college-enrollment-among-low-income-students-still-trails-richer-groups.

[7] Western Interstate Commission for Higher Education. "Knocking at the College Door: Projections of High School Graduates," December 2012. See www.wiche.edu/knocking-8th.

[8] Blair, Barbara Spies. "Babson Study: Over 7.1 Million Higher Ed Students Learning Online," Babson College, Jan. 15, 2014. See www.babson.edu/news-events/babson-news/pages/140115-babson-survey-study-of-online-learning.aspx.

Innovative boards: How to govern effectively and responsibly

Mary Foster, Managing Director, Not-for-Profit and Higher Education Practices

A few months into 2014, it is clear that institutions of higher education are not done experiencing financial and competitive pressures from the usual sources: market fluctuations, government policies, student demography, scrutiny of accrediting agencies and regulators. As institutions develop strategies to deal with these pressures, boards of trustees are experiencing a pressure of their own: a heightened expectation to weigh in.

Boards' role gains new attention

Over the next five years, boards will need to be more actively involved than ever in the long-term vision-setting process. Recent public controversy and investigations attest to the fact that they will have to do their work strategically and openly.

The national debate about board governance and the proper role of boards escalated with the June 2012 uproar at the University of Virginia, when its board was criticized for the sudden termination of the university president and its role in setting an accelerated timeline for dramatic curricula changes and other institutional reforms. Controversies over leadership and governance practices also made news at Texas A&M University, the University of Texas at Austin, Emory University, New York University, Arcadia University, the University of Illinois system, Valencia College and the University of Oregon.

Along with other increasingly public demands — seen in diminishing state support, families' increasing inability to pay tuition prices, lagging student outcomes and changes in academic technology — these leadership challenges will require boards to demonstrate effective and informed governance, as well as accountability, to stakeholders.

To serve effectively in providing oversight and thought leadership to the president and senior administrators, board members must be willing to engage in constructive criticism of their ideas and to ask the administration the tough questions that no one else will. Boards will need to reinvigorate their focus on the institutional core mission and risks, and not be narrowly focused on operations.

Keep issues in perspective

Significant matters that come to the board can cause a seismic shift in reputational stature and public trust if not handled correctly. It's not always easy to identify an issue that could potentially become a significant matter that would require aggressive action due to a change in priorities or a failure by management. Regardless, the board needs to be able to flag the incident and discuss it with leadership. Keeping risks, strategy and priorities in perspective — and in check — leads to a focused and collaborative governance process.

INNOVATIVE GOVERNANCE: 10 ESSENTIAL QUESTIONS BOARDS NEED TO ASK LEADERSHIP

1. **Ethics** — Has the institution defined and implemented ethics policies so that a culture of ethics is embedded in its operating, governance and academic policies and practices?

2. **Conflicts of interest** — Is there sufficient awareness of emerging best practices in the areas of identifying, vetting and managing conflicts of interest throughout the institution and the board?

3. **Risk identification and management program** — If the institution has not yet embarked on a formal enterprise risk management process, how has management gone about understanding the high-level strategic, operational and compliance risks that can impede the institution's success and erode marketplace trust and reputation?

4. **Technology and learning** — Has the institution developed a strategy that incorporates how new learning assessment technology and tools may be beneficial to students, faculty and academic performance?

5. **Technology and teaching** — Does the institution's strategy address the use of technology and online tools as part of delivering academic programs?

6. **Demonstrating student success and the value of education** — Does the institution have publicly available performance scorecards, with metrics on retention rates; four-year graduation rates; six- or nine-month postgraduation employment; and student internships, research fellowships and entrepreneurial grants?

7. **Tuition pricing philosophy** — Has the institution reviewed policies on tuition discounts and meeting the financial needs of students and families in conjunction with setting tuition rates for the next three years?

8. **Admissions and recruiting strategy** — Has the institution adapted its strategy to incorporate changing demographics, globalization and stagnant family incomes?

9. **Long-term market position and vision** — Has management articulated the risks and opportunities confronting the institution over the next three to five years relative to market standing, market niche, financial resources available to address market concerns, and the student academic experience?

10. **Integrated financial plan and dashboard** — Has the institution developed a strategic multiyear financial plan that, in a dashboard report, integrates key financial trends and results with strategic initiatives? Such a report should provide an institution-based view of operations, selectivity, endowment, capital investment, student success, and other key financial and nonfinancial drivers.

If necessary, take on governance structure

As boards evaluate and respond to governance questions, they might determine that it is time to look at the institution's governance structure and realign committees so that they are focused on the core mission and risks.

Some institutions, like Middlebury College, are restructuring their boards and establishing standing committees on strategy and new programs[1]. The intent is for the board governance structure to provide more support for risk management and strategic action. Others are studying materials from the University of Virginia's board workshop, conducted by Terrence MacTaggart, senior fellow at the Association of Governing Boards of Colleges and Universities[2].

Taking an even broader view, boards must acknowledge that, as institutions create interdisciplinary programs, the process for recruiting faculty and developing curricula significantly impacts the success of these programs. New committee structures can bring together the work of the academic affairs or educational policy committees and the faculty affairs committee to focus more holistically on program innovation, teaching innovation and campus facility needs.

As the demands on institutions and governance performance increase, boards must innovate their practices and structures to meet those challenges.

[1] Rivard, Ry. "Same Board, Fewer Committees," *Inside Higher Ed*, Dec. 13, 2013. See www.insidehighered.com/news/2013/12/13/middlebury-remakes-its-governing-board-manage-risks.
[2] Kiley, Kevin. "What's a Board to Do?" *Inside Higher Ed*, Aug. 17, 2012. See www.insidehighered.com/news/2012/08/17/uva-board-retreat-focuses-structure-and-attitudes.

1098-T penalty notices surprise colleges, universities

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During late summer 2013, colleges and universities across the country were greeted with penalty notices from the IRS related to Form 1098-T, *Tuition Statement*, and to incorrect or mismatched Social Security numbers (SSNs). In many instances, the penalties added up to tens of thousands of dollars.

Warnings not received, triggers avoidable

While it is fairly common for the IRS to annually issue penalty notices, two points jump out as different from other notices issued for incorrect Social Security or taxpayer identification numbers:

- Before any penalty is imposed, the IRS usually sends out a series of warning notices identifying the errors and providing procedures to avoid penalties. It wasn't done this time, and many higher education institutions were taken by surprise.

- Most of the penalties were related to individuals excluded from the Form 1098-T requirements who had received a 1098-T only to assist with potential tax credits or deductions.

Two of the most significant issues were: (1) nonresident alien students are exempt from the 1098-T requirements but were issued them anyway; and (2) many higher education institutions have indicated they cannot compel a student to provide a SSN for purposes other than payroll. For nonresident alien students, many colleges and universities issue the Form 1098-T as a courtesy, even though no SSN has been provided to the institution.

Balance needed in requesting, providing information

The Family Educational Rights and Privacy Act (FERPA) was cited as the reason for the difficulty in obtaining SSNs from students not employed on campus. The ambiguity of whether FERPA precludes institutions from obtaining SSNs for tax reporting purposes (i.e., Form 1098-T), combined with the sensitive nature of the law, puts colleges and universities in a difficult position. They must balance privacy issues — insisting on collecting an SSN when a student does not want to provide one — with offering students important information that is either required or could reduce their tax liability.

While it is rumored that the IRS will be abating these penalties for the 2011 year (i.e., the notices issued during 2013), it is likely notices will be issued in summer 2014, perhaps with the intention of being less lenient.

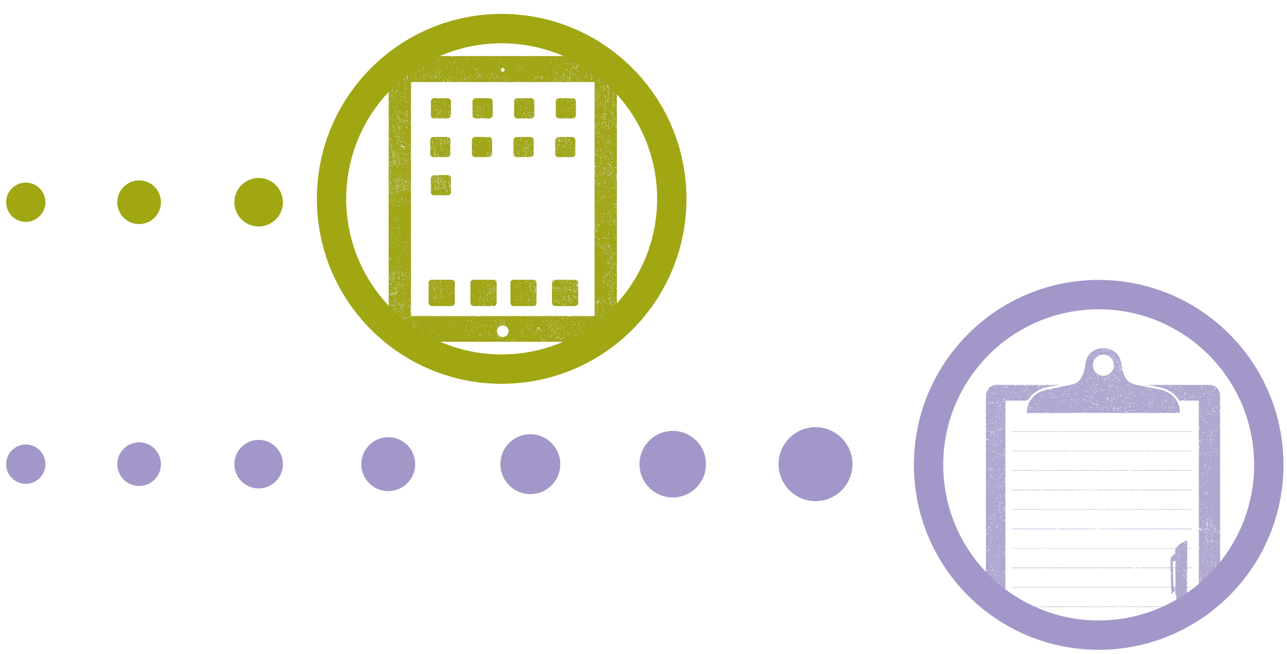
Take steps to avert penalties

A solid plan is critical to avoiding penalties or obtaining waivers. Colleges and universities should review their policies and procedures for verifying SSNs, sending out annual solicitations for SSNs from students who do not want to (or perhaps even need to) provide one, and continuing to issue Form 1098-Ts to all nonresident alien students.

Here are three actions your institution can take to avoid a penalty:

1. Advise nonresident alien students they will receive a Form 1098-T only if they provide an SSN.
2. Review policies and procedures with respect to issuing 1098-Ts.
3. Review policies and procedures for requesting SSNs and amending incorrect SSNs.

Two things are clear: The IRS will likely issue penalty notices for the 2012 tax year during mid-2014, and it may not be as lenient in abating penalties. Colleges and universities should not be caught off guard by these notices, and therefore should take steps now to become compliant with the 1098-T rules; planning ahead could prevent a costly surprise down the road.



5 steps for a high-performing internal audit function

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A strong internal audit (IA) function can provide your higher education institution with an independent, objective perspective; help improve its compliance and controls; and increase the efficiency and effectiveness of operations. Here are a few recommendations to maximize the value provided by your IA function, based on our experience as outsourced and co-sourced internal auditors, as well as our knowledge of industry best practices:

1. **Establish a strong tone at the top.** Support from leadership is crucial to the IA department's ability to function effectively and help your institution be at the top of its game. Strong support from the board and senior management helps communicate the importance of IA's activities to the institution's community. IA should regularly discuss findings, recommendations and emerging risks with senior leadership, and develop value-added, implementable recommendations that can trigger positive change within your institution. Although the IA function needs to earn its reputation for excellence, we have seen that senior management's open support can pave the way for an efficient and effective IA function.

KEY INTERNAL AUDIT ROLES

The objective of IA is to help the organization achieve its goals by using a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance. Here are six fundamental IA duties:

1. Identify and prioritize areas of risk throughout the organization.
2. Mitigate these risks through targeted audit plans, resulting in findings and recommendations for change.
3. Evaluate the effectiveness of internal controls from a best practices perspective.
4. Assess compliance with laws, regulations and contracts.
5. Recommend process improvements that address the efficiency and effectiveness of operations.
6. Follow up on recommendations and report on remediation efforts.

2. **Promote the IA function's independence.** IA should be independent from management and the business functions that it reviews in order to allow the department to perform its duties in an unbiased manner, free from interference or compromised relationships. Ideally, IA should report directly to the board of trustees or the audit committee, although we have often seen it report administratively to the president, executive vice president, CFO or general counsel. An independent and objective IA department can more effectively monitor the institution's compliance and controls, and decrease the risk of fraud.

3. **Line up skilled, flexible resources.** IA knows to expect the unexpected. Special projects, "fire drills" often associated with fraud or special investigations, and shifting priorities are now the norm in higher education. Many IA functions struggle to provide value when these projects involve academic or programmatic areas, often due to a lack of experience. A skilled and diverse staff is needed to deal with the unexpected and to create and effectively execute a well-rounded audit plan. A high-performing IA department should include staff with a mix of skills and experience, including compliance and controls, academic and programmatic areas (e.g., grants), operational improvement, and more specialized areas such as IT systems and infrastructure. If your institution has a modest IA staff, consider co-sourcing as a viable way to supplement existing in-house skills and resources with specialized talent and experience.

4. **Leverage IA's expertise in strategic risk assessment.** In an increasing number of higher education institutions, IA no longer simply acts as an institution's compliance cop. Many strong IA functions have also been serving in a consultant-like capacity, making recommendations to improve the university's operational efficiency and effectiveness. To become a high-performing function, IA's observations and recommendations must provide actionable insights that align with your institution's strategic priorities and provide maximum value to your institution. Increasingly, we have seen institutions' IA functions participate in the institutional enterprise risk management (ERM) program. IA's risk assessment experience and institutional knowledge can be great resources when you set out to identify the risks to achieving your strategic goals (i.e., strategic risk). IA can also participate in the ERM process by assessing current and recommended risk mitigation practices.

5. **Perform a quality assurance review (QAR).** The Institute of Internal Auditors (IIA) recommends that self-assessments of the IA function be performed periodically (we suggest annual IA self-assessments), while third-party assessments should be performed every five years. A QAR can be a key driver in improving IA's performance because it assesses the function's adherence to the IIA's International Standards for the Professional Practice of Internal Auditing and Code of Ethics. The QAR also evaluates how effective the IA function is in fulfilling its mission, and identifies ways to enhance IA's management and work processes, as well as the value it ultimately brings to the institution.

PCI DSS compliance: IT and beyond

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Conventional wisdom says that achieving Payment Card Industry Data Security Standard (PCI DSS) compliance for storing, processing and transmitting cardholder data across a university begins and ends with the IT department. In reality, this is only part of the story. Of course, IT has an enormous role to play, but so do key business departments such as registration and records, food service, and the bookstore. In fact, some of the most successful PCI DSS compliance initiatives are those led by the organization's treasurer or others responsible for processing payments. Unless all groups — business and IT — work toward a common purpose and shared commitment, PCI DSS compliance may be elusive.

Know the risks

Colleges and universities that store, process or transmit cardholder data must be in compliance with the PCI DSS or face fines and other penalties from the merchant's acquiring bank. The PCI DSS includes well over 200 requirements, ranging from the need to maintain strong security policies to network penetration testing and rigorous vendor oversight.

Universities have a lot to lose in a breach. A breach could damage the institution's reputation immeasurably, which may lead to a loss of funding and public support, burdensome credit monitoring costs, and delayed insurance claims. An acquiring bank may impose fines on a noncompliant institution; put an organization on an accelerated compliance schedule; minutely scrutinize controls; initiate formal reviews; or refuse to accept new accounts.

Government agencies are taking a keen interest in ensuring that consumer financial data is protected: Both the Federal Trade Commission and the U.S. Department of Justice have launched probes into the recent Target and Neiman Marcus breaches. For its part, the public seems willing to allow the government greater latitude in security and privacy enforcement matters.

Build organizational commitment

Despite the possible risks, PCI DSS compliance may not weigh heavily on the minds of many higher education administrators and leaders. Building awareness of the PCI DSS and commitment to compliance takes resources and determination.

Conducting a PCI DSS readiness review is a great place to start. The review begins with a kickoff in which university leaders describe the importance of PCI DSS compliance to both business and IT administrators. Interviews; facilitated sessions; and frequent, informal meetings can help engage key stakeholders and reveal a deeper understanding of the business and IT processes involved in storing, processing and transmitting cardholder data. Finally, the overt and tangible commitment to PCI DSS compliance by the CFO and other leaders can help drive the message home.

Leadership is critical

Every successful initiative starts with effective leadership. While PCI DSS compliance requires the involvement of individuals from across many university departments, commitment from a key administrator can make all the difference. At many universities, CFOs and treasurers often become the focal point of the PCI DSS compliance initiative, largely because payment processing is a critical business practice. The CFO's strength is a broad understanding of finance's role across the university; the treasurer's advantage is tactical know-how.

No matter the choice, the person in charge of assuring PCI DSS compliance should have these qualities:

- Hold a position of visibility and authority
- Be thoroughly steeped in university operations
- Be well-versed in IT and financial processes
- Have the capability to bring together knowledgeable (and independent-minded) people
- Be able to garner the support of other senior management
- Have direct contact with the acquiring bank and card brands

Key to success: Involving the whole organization

All departments must work together to achieve PCI DSS compliance. One powerful approach is to limit the type and amount of cardholder data that the institution processes, stores and transmits. At little to no cost, business processes may be modified slightly to minimize risk. In one case, an organization that had previously accepted emails and paper forms from students with their names, credit card numbers and CVV codes, initiated a policy requiring students to enter the information into a secure website. This practice — initiated by the finance department — prevented the organization from having to take possession of the data and implement expensive technology to mitigate the problem.

Plan for long-term PCI DSS compliance

The key to adopting PCI DSS compliance across a college is taking a practical, risk-based approach. The PCI Security Standards Council has developed a prioritized approach for remediation activities. By pacing the remediation process and developing a long-term plan for fixing issues, the institution can work within budgetary constraints.

3 steps toward compliance

- First, patiently and persistently develop an organizational commitment.
- Second, designate a leader to help promote the program to the senior leadership team, and enlist the support of the entire institution to identify and make process changes.
- Finally, use a practical and strategic approach to prioritize risks and remediate them.

PCI DSS compliance is one of the myriad programs, rules and laws requiring protection of student, employee and consumer data. Its impact can be felt across the university, and its risks are far-reaching. With a well-designed and well-executed compliance program in place, your institution will be better positioned to protect its data and its reputation.

12 REQUIREMENTS OF PCI DSS

1. Install and maintain a firewall configuration to protect cardholder data.
2. Do not use vendor-supplied defaults for system passwords and other security parameters.
3. Protect stored cardholder data.
4. Encrypt transmission of cardholder data across open, public networks.
5. Use and regularly update anti-virus software.
6. Develop and maintain secure systems and applications.
7. Allow access to cardholder data on a need-to-know basis.
8. Assign a unique ID to each person with computer access.
9. Restrict physical access to cardholder data.
10. Track and monitor all access to network resources and cardholder data.
11. Regularly test security systems and processes.
12. Maintain a policy that addresses information security.

The new collection agency: How the Treasury Offset Program tracks universities' state income tax filings

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Colleges and universities are experiencing federal debt offsets. The system is not new, but the coordination between federal and state governments is gaining unprecedented traction and sophistication, especially due to the actions of Debt Management Services (DMS).

Part of the Department of the Treasury's Bureau of the Fiscal Service, DMS works with federal government agencies to provide debt management programs and collection services to states.

DMS has proven to be very effective: Its fiscal 2012 annual report to the states describes how all 50 states, the District of Columbia and three territories have maximized delinquent debt recovery efforts through participation in the Treasury Offset Program[1]. The state income tax program, which includes 40 participating states and the District of Columbia, recovered more than $560 million to states in fiscal 2012.

Real-life example

How might DMS's programs affect your higher education institution? Consider this real-life example from one of our clients:

A university was expecting a payment from a federal agency for a research grant. The state of New York alleged that the university owed state income tax and reported the amount to the DMS database. Before DMS released the federal research grant payment, it withheld the state tax liability from the grant payment. As a result, the university received the grant payment minus the alleged state income tax.

The university controller, sponsored research accounting director, tax director and payroll manager began to investigate the situation. The alleged New York income tax had been paid, but the university needed to look into the delinquency and determine how best to proceed with filling the research grant gap. Once the facts were determined, the university reconciled the payments and amounts due and collected involving the federal and state governments. During the investigation, the university needed to cover the missing grant money in order to continue the research, keep people employed and reconcile the activity on any grantor-type reporting.

[1] Department of Treasury. "Fiscal Year 2012 Report to the Congress." See www.fms.treas.gov/news/reports/debt12.pdf.

File appropriately to avoid costly penalties

Full compliance with payroll and income tax withholding and filing requirements has always been recommended due to federal and state civil and criminal penalties for failure to file tax returns or withholding taxes. Still, many institutions assume the risk and decide not to file. The consequences for failure to file may involve groups or constituencies within an institution that demand immediate attention, such as the provost's office, the audit, risk and governance committees, and the president's office, among others.

Here are a few ways your institution can avoid trouble:

- If an employee resides and works in another state, make sure payroll withholds the proper state income tax.
- If an investment is made through a partnership and, because of that investment, the institution has a state income tax filing obligation, your institution should file an income tax return.
- If you have a student in another state taking distance learning classes, your institution should confirm all state Department of Education and regulatory filing requirements.
- If an employee is conducting fundraising activities in other states, your institution should confirm all solicitation and registration-filing requirements.

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— **Christine M. Wilda**, Senior Vice President for Administration and Finance; Treasurer, University of Massachusetts

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