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Not-for-Profit Brief

From the **Business, Industry & Government** Team

Increasing Risk Awareness for Mission Critical Objectives of Not-for-Profit Organizations

Substantial attention is now being placed on the effectiveness of how senior executives and boards are managing and overseeing the multitude of risks impacting the future success of the organizations they serve. Some of that attention is the result of hindsight analysis of organizations that failed during the recent economic turmoil that revealed, in retrospect, excessive risk-taking on the part of management in the pursuit of strategic objectives and goals. Others have seen how broader macro-level risks (some refer to these as "systemic risks") can arise outside the walls of the organization with catastrophic impacts.

Governance reform proponents are calling for more systematic and robust risk oversight processes to strengthen board and senior management oversight of risks potentially affecting the organization. For example, the Securities and Exchange Commission now requires all public companies to include disclosures in their proxy statements describing the board's role in risk oversight. Standard & Poor's is including reviews of an entity's enterprise risk management practices as part of the credit rating analysis they conduct for entities that finance operations through large debt obligations. As a result of these and other reform calls, greater risk awareness is becoming an expected best practice in overall governance of an organization.

More importantly, executives and boards are now realizing that better risk oversight provides the organizations significant strategic advantage that can increase the likelihood that key strategic objectives and goals are achieved. Knowing that organizations, including not-for-profits, must assume risks if they want to further advance their mission, executives are now seeing the strategic value of being more informed about those risks that might positively or negatively affect their mission goals and objectives. As the volume and complexities of risks continue to increase and the speed of change associated with certain types of risks only becomes more rapid, executives who have sought to strengthen the robustness of their risk management processes are realizing significant advantages of being more proactively informed about potential emerging risks that might threaten the viability of key strategic initiatives.

Relevance of Risk Oversight to Not-for-Profits

Because some of the calls for greater risk awareness appear to be coming from voices associated with for-profit corporations, some may naively conclude more effective risk oversight is a corporate issue that isn't relevant to not-for-profits. That perspective is dangerously wrong. Not-for-profits are not immune to risks as they seek to accomplish their mission and vision, especially in light of the impact the tough economy is having on donations and endowments and threats to significantly reduced government grant programs and cuts in funding as governments tighten their belts significantly.

Developing an Enterprise View of Risks

Many organizations are responding to these increased expectations for greater insight by embracing an enterprise risk management (ERM) perspective as they oversee the organization's top risk exposures. The objective of any ERM process is to provide assurance to management and the organization's key stakeholders that the organization is more likely to achieve its objectives. More formally, COSO's *Enterprise Risk Management - Integrated Framework* (2004) defines ERM as follows:

> *Enterprise risk management is a process, effected by the 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 the risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.*

Many have questioned how ERM differs from traditional risk management. Clearly, if a not-for-profit is able to open its doors on a given day to deliver services, it is managing risks to some extent. However, often their focus on risks is done in silos whereby certain aspects of the core operations are considered from a risk perspective with little information about how their management of those risks might affect other aspects of the organization. For example, the information technology function as shown by the blue silo in Figure 1 below would be responsible for managing risks that might threaten IT services. But, in doing so, they may be unaware of how their IT risk management activities might impact finance or donor services. Likewise, risk managers in finance or donor services silos may be unaware of how their actions might threaten the viability of IT operations. Thus, an enterprise perspective of risks is lacking.

Explicit Focus on Emerging Strategic Risks

Even more critical is the lack of focus on emerging risks that might arise from external sources outside the walls of the not-for-profit organization. So often, traditional risk management activities focus on known risks to internal operations tied to their silos of responsibilities with inadequate attention placed on unknown, but knowable risks that might arise from external forces. For example, changes in donor profiles, modifications to government programs, and variations in charitable giving can often arise from factors outside the walls of the not-for-profit.

The goal of ERM is to increase an organization's risk awareness by creating a top-down integrated view of the enterprise's most significant risk exposures that may be driven by both internal

Figure 1

Traditional Risk Management Approach

"Silo" or "Stove-Pipe" Risk Management

and external factors. By accumulating information about key risk exposures from across the entire enterprise, organizational leaders are able to see the portfolio of risks they may be assuming which they can use to evaluate whether the amount of risk-taking is within the appetite of key stakeholders.

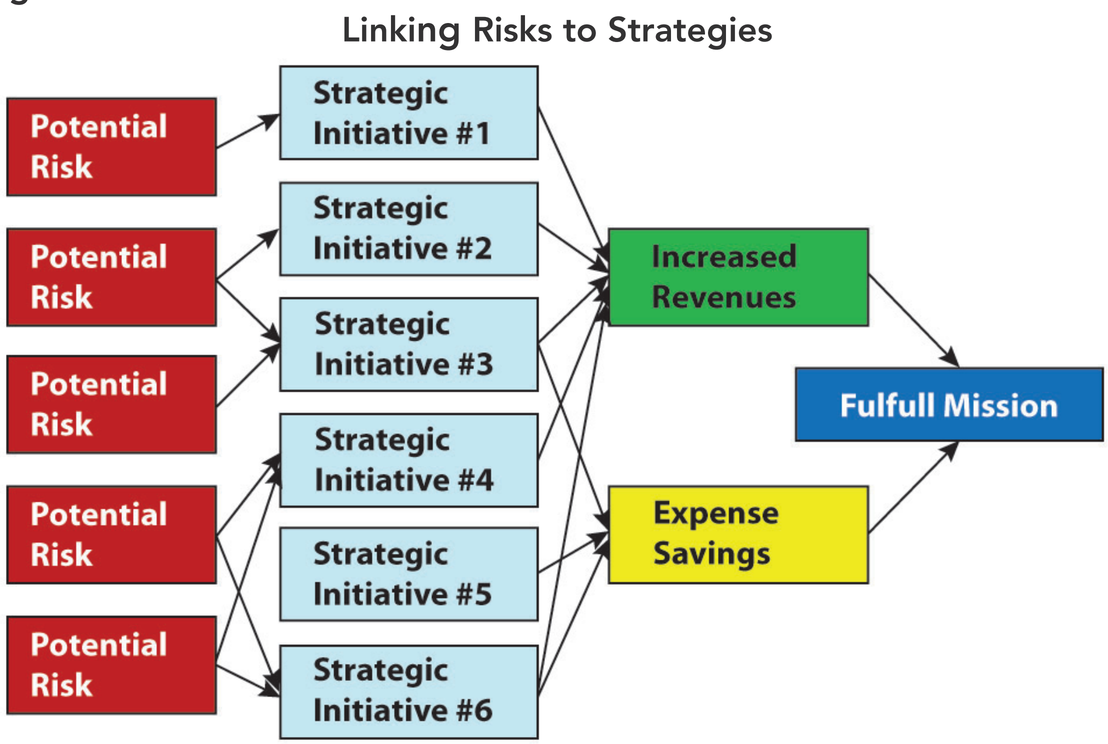
Where to Start?

At first glance, implementing effective enterprise-wide risk management processes can appear daunting. Unfortunately, many organizational leaders view ERM as a complex task requiring the need for sophisticated software, consultants, or new FTEs. Thankfully, significant benefits can be achieved by starting with a simple top-down conversation among not-for-profit leadership and key stakeholders about their views of the top 10-15 risks likely to threaten the organization's mission critical objectives. Keeping this simple, but top-down focused approach to risk oversight allows organizations, such as not-for-profits, to implement some fundamental ERM concepts with relatively minimal budgetary impact.

Significant gains can be achieved cost effectively by engaging the organization's top leaders in focused discussions that help them link mission critical strategies and key risks as illustrated in Figure 2. Like for-profit organizations, a not-for-profit organization has agency-wide goals and objectives the organization seeks to achieve. While not-for-profits may not seek to achieve profitability goals, they are charged with providing mission critical services to their key stakeholders and recipients of services. To fulfill those mission critical services, they design and execute various strategic initiatives that are targeted towards fulfilling mission-related objectives. Focused discussion around the agency's key strategic initiatives is an effective starting point to identifying some of the most important top risk exposures.

From that point, leaders can begin to think about categories of issues that might represent key drivers of risks that are likely to impact the agency's ability to accomplish core strategic initiatives important to the achievement of its mission. A focused discussion about major risk drivers in the context of specific strategic initiatives may help organizational leaders better recognize risks relative to each core strategic initiative. As illustrated by Figure 2, strategic initiatives are

Figure 2



likely to be impacted by a multitude of risks that might alter the agency's ability to execute the strategic initiative. And, this type of focus may help leaders identify risk drivers likely to affect not only one strategic initiative, but several. That kind of attention helps management prioritize risks that create the most significant exposure to the agency's ability to accomplish its mission.

While a full-blown approach to ERM contains other more detailed processes, this kind of focused conversation about core strategies and major risks can quickly provide a top-down focus on the most significant enterprise level risks to manage. As time goes on, the process can mature into a more robust enterprise-wide analysis that can be rolled out across the agency's key leadership.

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