

# ENTERPRISE RISK MANAGEMENT

## in the Great City Schools

SPRING 2016



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**The Council of the Great City Schools** is the only national organization exclusively representing the needs of urban public schools. Composed of 70 large city school districts, its mission is to promote the cause of urban schools and to advocate for inner-city students through legislation, research, instructional support, leadership, management, technical assistance, and media relations. The organization also provides a network for school districts sharing common problems to exchange information and to collectively address new challenges as they emerge in order to deliver the best education for urban youth.

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# CONTRIBUTORS

**Scott B. Clark**

Risk and Benefits Officer  
Miami-Dade County Public Schools

**Kristen Devan DeCato**

Director of Department of Procurement & Risk Management  
Milwaukee Public Schools

**Dave George**

Executive Director of Risk Management  
San Francisco Unified School District

**Dana Henderson**

Director of Risk, Safety & Environmental Management  
Charleston County School District

**Aston A. Henry, Jr.**

Director of Risk Management  
Broward County Public Schools

**Christopher Hoch**

Director of Risk Management & Human Capital Initiatives  
Rochester City School District

PRINCIPAL ADVISOR:

**Dorothy Gjerdrum**

Senior Managing Director  
Gallagher Public Sector & ERM Practice

STAFF LEAD:

**Robert Carlson**

Director of Management Services  
Council of the Great City Schools

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## Introduction and Purpose

Public schools have a mandate to educate children in a way that is safe, effective, and cost efficient. The risks involved in achieving that mandate have become increasingly complex, and the need to manage those risks has never been greater.

The emergence of widespread, interconnected risks, such as cyber risks and data management, infrastructure risks, privacy, the threat of terrorism, and workplace violence makes it clear that the nation's public schools need a new approach to managing risk. Many of the most pressing risks and the uncertainties associated with achieving a school district's key mission go beyond insurable risks or activities under the direct control of a school district; they now include a broader range of uncertainties. A broader approach to risk management is needed.

The challenge for members of the Council of the Great City Schools is to identify best practices in managing risk, referred to in this paper as Enterprise Risk Management or ERM. The purpose of this white paper is to present key concepts of ERM and enhance the understanding of how to apply ERM to a K-12 public school setting.

## Operational Risk Management and the Evolution of ERM

The profession of risk management has been evolving since the late 1970s, when individuals responsible for purchasing insurance began to seek alternative ways to finance risks. The liability insurance crisis of the mid-80s, when the cost of insurance soared and availability diminished, furthered the development of self-insurance and other risk financing alternatives. In the decades that followed, the concepts of managing operational risks through training and prevention, claims and litigation management, and increasingly sophisticated risk financing structures flourished.

In the United States, operational risk management grew out of issues that related to safety practices and regulations, insurable risks, and the management of claims and loss prevention. Traditional concepts of operational risk management can include any or all of the following components:

- Insurance coverage, such as workers' compensation, property and liability (general, automobile, professional, school board legal, law enforcement)
- Safety, loss prevention, or risk control
- Claims management
- Student and athletic accident programs
- Employee benefits
- Supplemental retirement programs

Operational risk management views risk as bad and something to be minimized or mitigated. Treatment methods include reducing potential negative outcomes (through a variety of techniques, such as risk control, training, early intervention, and claims management), transferring the consequences (usually to a third party or an insurance company), or avoiding risk altogether (by not engaging in an activity, for example).

These are effective treatment methods for managing threats that are predictable and within the direct control of schools. However, over the past 40 years, the world of risk has changed dramatically. Natural catastrophes, terrorist events, and financial and global crises have increased the need for risk management solutions that go beyond risk financing and prevention. In addition, organizations that consider how to take risks as part of their overarching strategy, that is, choosing to take calculated risks in some cases, are organizations that have led the way to a broader approach to risk management or ERM.

The following illustration outlines the evolution of risk management over the past 30 years as it has expanded to become more strategic.

<b>“Traditional” Risk Management</b>	<b>Advanced Risk Management</b>	<b>Enterprise Risk Management</b>
Transactional in nature	Focused on integrating risk functions	Focused on strategy & prioritization
<ul style="list-style-type: none"> <li>• Purchase of insurance to cover risks</li> </ul>	<ul style="list-style-type: none"> <li>• Greater use of alternative risk financing techniques</li> </ul>	<ul style="list-style-type: none"> <li>• A wide range of analytical tools are used to identify and respond to key risks to mission and strategy</li> </ul>
<ul style="list-style-type: none"> <li>• Hazard-based risk identification and controls</li> </ul>	<ul style="list-style-type: none"> <li>• More proactive about preventing and reducing claims</li> </ul>	<ul style="list-style-type: none"> <li>• A wide range of risks are considered – strategic, financial, operational, and reputational</li> </ul>
<ul style="list-style-type: none"> <li>• Compliance issues addressed separately</li> <li>• Safety &amp; emergency management are separate functions</li> </ul>	<ul style="list-style-type: none"> <li>• Integrates risk-related functions such as claims management, contracts review, special events risk management, loss control/prevention</li> </ul>	<ul style="list-style-type: none"> <li>• Uses a broader definition of risk to include opportunities and focus on uncertainties to mission</li> </ul>
<ul style="list-style-type: none"> <li>• Focus is on cheapest cost of insurance premiums</li> </ul>	<ul style="list-style-type: none"> <li>• Cost allocation used to share costs and hold departments accountable</li> </ul>	<ul style="list-style-type: none"> <li>• Helps manage growth, allocate capital and resources</li> </ul>
<ul style="list-style-type: none"> <li>• Risk management is handled by individual departments</li> </ul>	<ul style="list-style-type: none"> <li>• More collaboration among departments</li> </ul>	<ul style="list-style-type: none"> <li>• Risks are prioritized by a broad group and owned by those with direct control</li> </ul>
<ul style="list-style-type: none"> <li>• The risk manager is the insurance buyer</li> </ul>	<ul style="list-style-type: none"> <li>• The risk manager may be the risk owner for the district</li> </ul>	<ul style="list-style-type: none"> <li>• The risk manager is the risk facilitator and leader</li> </ul>
<p><b>Risk is <i>bad</i> – focus is on transferring risks</b></p>	<p><b>Risk is an <i>expense</i> – focus is on reducing the cost of risk</b></p>	<p><b>Risk is <i>uncertainty</i> – focus is on optimizing the management of risk to achieve goals</b></p>

## ERM as Described by ISO 31000 – and What It Means for District Operations

The risk management landscape changed significantly in the years between 2004 and 2009. In 2004, Australia and New Zealand revised their standards for how to manage risk, and the Committee of Sponsoring Organizations (COSO) issued its ERM framework. Both occurrences were game changers in the practice of risk management. COSO, which represents audit and financial organizations, issued directives to internal auditors to assist in the identification, assessment, and treatment of all risk (strategic, operations, reporting, and compliance).

At the same time, the Australian and New Zealand standards became the basis for the first international benchmarks in the practice of risk management, a practice that was created by risk experts from over 30 countries around the world. In addition, ISO 31000, “Risk Management Principles and Guidelines,” was published in 2009 after four years of work by the International Standards Organization (ISO).

Informed by these important publications and by the desire of many organizations to create a broader and more inclusive attitude towards risk, the practice of risk management expanded beyond insurable risks and finance mechanisms into how to consider risks as a part of organizational strategy and mission. This new practice emphasized that everyone has a role to play in managing risk, and that a consistent and comprehensive approach—and indeed the *purpose* of managing risk—is to help districts focus on and achieve their mission and strategic objectives.

ISO 31000 was published to guide organizations of any size or type to implement a broader approach to risk management. The document amounts to a guidance standard rather than a compliance standard, because it recognizes that each organization needs to scale and tailor its framework for and process of risk management to its particular operations and mission.

The ISO standard defines risk management as a coordinated effort to direct and control all activities related to risk. It defines risk as the effect of uncertainty on objectives. It therefore ties the management of risk to what is most important to the organization.

ERM recognizes that there are times when accepting (or embracing) and working with risk (in service of a goal or objective) is appropriate. For example, school district leaders may decide upon three unique strategic goals to reduce the achievement gaps among students. There are risks associated with those goals that may increase the likelihood of success as well as risks that may negatively affect the outcome. ERM would help leaders consider and balance the uncertainties that surround possible outcomes and prioritize them in a way that would best support positive outcomes and minimize threats. As risks are identified, prioritized, and evaluated, leaders can determine how risks will be managed – and by whom. The entire process is meant to sharpen one’s aim and focus and enhance the achievement of strategic goals.

ERM envisions that eventually all decisions made by an organization will utilize a consistent and inclusive process that will consider objectives, uncertainties, and possible outcomes before a decision is made. This risk-based decision-making process begins with a discussion of context, which helps participants understand the importance of the decision in relation to school district mission, strategy, and goals. Leaders will also consider the operational context (which includes the legal and regulatory environment, the financial and cultural climate, and so on), and the process for doing so will engage appropriate internal and external stakeholders. The process considers both positive and negative outcomes (or threats and opportunities related to a decision) and evaluates the organization’s ability to manage identified risks. The entire process is characterized by continuous communications, along with monitoring and revisions to maintain risks within an organization’s level of tolerance. The process also identifies risk owners, establishes reporting lines, and considers budget implications.

## Key Differences and Challenges

In larger school districts, like the Great City Schools, traditional risk management is usually led by a trained risk professional and a small staff. Claims management, loss prevention, underwriting, and benefits may be provided by in-house staff or outsourced to external service providers. Sometimes, specific risk-related operations—such as employee benefits or workers’ compensation—may be handled by a separate department.

In other cases, risk management becomes an additional duty assigned to existing personnel (such as emergency management, procurement, audit, former administrators or human resource personnel). This practice can raise difficulties if those duties are secondary to other responsibilities or if technical and leadership skills are lacking. This situation can also create too much costly reliance on outside experts, such as insurance brokers and consultants.

The organizational location of the risk management function varies widely among school districts. A full-time risk manager may report to the school district’s chief financial officer, the director of human resources, or the legal department or may be a member of the superintendent’s cabinet or senior staff. To some extent, the importance that the organization gives to risk management is often reflected in the placement of the risk management position and its reporting protocols.

Regardless of position or roles, risk managers who remain focused on operational risks typically develop excellent technical skills in risk financing, claims management, prevention, and risk control. However, the skills needed to advance ERM are more likely to focus more on communications and facilitation, strategic thinking, and leadership. A “traditional” risk manager may find that the lack of these skills limits participation in strategy setting or decision making at a broader more strategic level. As ERM engages in supporting strategy and opportunity, it becomes more closely linked to district management, decision making, and policy-setting across the entire district. This level of activity requires a far different skill set and organizational positioning to be effective.

A fully developed ERM program is often led by a chief risk officer (CRO), a position equal to other chief officers or senior staff. The CRO typically reports to top management, the school board's audit committee, or sometimes, directly to the board itself. Although the authors of this paper are unaware of any public school district that currently employs a CRO, this is a growing practice among institutions of higher education and large public entity operations. There are a number of K-12 school districts (members of the Council of the Great City Schools) that are currently implementing ERM and whose risk managers are included on the superintendent's senior staff.

Two other significant differences between operational risk management and ERM are worth noting. One relates to the emphasis on risk ownership, which recognizes that the person who has direct control over a specific risk is the one best positioned to manage it. After key risks are identified by a broad group of stakeholders and prioritized in relation to a district's goals and strategy, a risk owner is identified for each one. This is a shift away from one person (or department) holding risk management expertise to a practice akin to making everyone a risk manager. Training all employees on how to assess and handle risk and holding risk owners accountable for managing risk to within tolerable limits are hallmarks of an effective ERM program.

Finally, in an ERM program, risk is always prioritized and considered in relation to organizational objectives. Risks to strategy and mission elevate the consideration and prioritization of risk. These considerations also assure that a district will be allocating resources appropriately, that is, to where they are most needed and will be most effective. This differs from a more traditional approach where risk is identified and evaluated according to its potential negative effects, insurability, or the ability of the organization to transfer or finance the risk.

## Making the Business Case – One School District’s Example

Although ERM is often described as ideally having a top-down approach with buy-in and directives from the superintendent and senior management, public schools are not always managed by a distinctly top-down approach. As a result, opportunities to grow ERM organically within an organization are possible. For example, in some districts, school sites are given wide autonomy in their budgeting, hiring, and instructional programming. Enterprise-wide risk can therefore be introduced around specific projects or strategic initiatives.

One example comes from the San Francisco Unified School District (SFUSD). In San Francisco, all schools partner with community-based organizations (CBOs) to provide much-needed ancillary support such as tutoring, childcare, mentoring, reading programs, and so on. SFUSD works with hundreds of organizations that provide services to students and families, organizations that might present liabilities and risks to the school district. Because these services typically are free, they fall outside the normal contracting process that has been established by the district. In an effort to create better structures and supports for these groups that would result in maximum success for both the district and the various CBOs, an ERM lens was applied.

At the outset, the goal of the district’s work was to align the needs of its schools with the available resources provided by the CBOs. First, an existing strategic tool was used (ERM works best when one doesn’t reinvent the wheel but uses what an organization already has in place). The Results Oriented Cycle of Inquiry (ROCI) was a model for continuous improvement that was already being used by SFUSD. This tool was used by a cross-functional staff team and became the basis for articulating the process and workflow dealing with CBOs. Out of that process came staffing and software for developing and tracking MOUs. This formed the basis for identifying and outlining contractually the expectations of each party, as

well as the process for background clearances, appropriate drug screening, TB testing, insurance, etc.

In addition to articulating operational components of the work with CBOs, what arose from the process was an *opportunity* identified by school site leaders to look at each CBO working in their schools and make key decisions about whether that work aligned with their priorities in their Balanced Score Cards (BSC). The BSC was the second strategic tool used by the schools to outline their vision and goals. In some cases, it was determined that, while the work of a CBO was worthwhile, it did not align with a particular site's most urgent needs and goals, and the relationship was consequently discontinued or redirected to better align with those goals. This process allowed each principal to assess the "risks" of having more CBOs than he or she could manage or to engage CBOs with a mission that was more aligned with the school's mission. This process helped principals focus on key services they needed from CBOs that would better support the achievement of goals set by their school community.

From a risk management perspective, what began as a focus on compliance (MOUs, insurance, etc.), expanded into an ERM model that provided support for strategic objectives and services to better serve the needs of students. It resulted in a process that was broader than simply managing risks through insurance or other similar risk tools.

Other examples of programs that could benefit from the broader lens of ERM include special education, student health programs, and business services such as accounting or human resources.

## What's the Return on Investment?

One opportunity to promote the concept of ERM in large urban school districts involves making a business case for the idea and establishing what senior management can expect in terms of return on investment (ROI). The processes of determining ROI expectations and clarifying key performance indicators need to be specific to a district's needs.

Some examples of ROI for ERM include:

- A defined risk management framework and a specific approach to managing *all risks* specifically described for bond-rating agencies.
- Reciprocal benefits and coordination between internal audit and risk management activities and sub-functions.
- Better education for board members and management on key risks to help them fulfill their oversight and governance roles.
- Collaborative work on risk-related problems (such as the CBO process used by SFUSD).
- Regular internal and external environmental scans for existing and emerging risks.
- Intentional engagement of managers at multiple layers to identify risk concerns and establish connections with other aspects of business operations and strategy.
- Avoidance of penalties and fines for lack of compliance as key risks are identified and managed.
- Development of an overall register of key risks for the district and tracking of treatment and plans.
- Treatment plans for prioritized risks provide a credible defense in the face of litigation.
- Gaining the confidence and trust of key stakeholders through communications about the risk management program – demonstrated through engagements, reports, and activities and verified through surveys and feedback.

A broader conversation and identification of risk—including emerging risks and trends—will increase preparedness and ability to respond. The risk assessment process is more pro-active than a post-crisis reaction mode and considers best case/worst case scenarios and responses.

## Potential Action Items for Implementing ERM

ERM takes time to implement; it is often described as a three- to five-year endeavor. Although few (if any) districts would claim to have fully implemented ERM, many districts have begun to apply ERM incrementally. The following action steps, in conjunction with the Best Practices outlined in the Appendix, are intended to help districts create an ERM implementation plan.

### Action Item #1 – Create a Business Case

Make a business case for implementing ERM. Along with clear messages about the benefits and potential ROI, this step can persuade key decision makers to support a broader approach to managing risk. The business case should be built to support what matters most and tied to strategy, goals, and objectives.

### Action Item #2 – Express Your Commitment to Risk Management

The superintendent is responsible for stating the importance of managing risk and support for the district's risk management framework and process. The message should clearly communicate that the district takes risk management seriously and that everyone is responsible for managing risk. Developing the risk management framework and process requires that senior management and the superintendent understand the evolution and importance of taking a broader approach to managing risk than has typically been the case.

### **Action Item #3 – Think About Structure**

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ERM, as defined in ISO 31000, must be scaled and tailored. This step means that each district must consider the structure, staffing, and approach that would be the best fit for managing risks to its operations. Districts sometimes begin by creating an overall inventory of how risk is currently managed – in order to develop a plan for risk management to become more consistent, broader, and more integrated. Other options that can help a district develop a more tailored approach include creating a study group or advisory committee, launching a pilot project or case study, or hiring an ERM advisory or consultant.

### **Action Item #4 – Describe How You Will Manage Risk**

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Districts may define their risk management framework and process in a policy statement, administrative order, or simply through practice and protocol. The description of how and why one manages risk should delineate a sustainable framework, the process for assessing risks, and the methods for continual improvement. Issues such as roles, accountability, and performance measurement should be addressed. This may include clarifying the roles of managers, risk owners, and employees in identifying and managing risk, as well as establishing key performance indicators, key risk indicators, and risk criteria. The ISO 31000 standard provides excellent detail on how to establish and create a sustainable framework and implementation plan. Many districts are currently working on this approach, and it is the intention of the authors of this paper to publish additional white papers to provide implementation guidance.

### **Action Item #5 – Communicate**

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The purpose and importance of ERM should be communicated to the entire district and community. Senior management should construct a communication process that ensures that key stakeholders are informed of progress and risk management results. Communication should be transparent and provide a foundation for ongoing monitoring and improvement.

Examples of how risk management monitors and documents results:

- Regular reports to governance bodies (school board or committees)
- Communications to internal and external stakeholders
- Annual reports
- Reports to regulators, financial agencies, or oversight bodies
- Reports to risk financing organizations

## Action Item #6 – Apply Risk Management to Decision Making and Procedures

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Seek opportunities to apply the risk-based decision-making process to individual projects, problems, or opportunities. For example, an ERM process could help a district understand its best response to coping with an impending deficit in their food service program while continuing to provide desirable, hot, and nutritious meals and remaining compliant with regulations. The process won't necessarily eliminate risk or guarantee an outcome, but it can help the district be better informed as it makes difficult decisions.

Another example might apply to the problem of late bus runs. Imagine engaging multiple stakeholders in considering the implications of late bus runs on student attendance, instructional time, and operational efficiencies. A thorough review of sources, triggers, likelihood, consequences, and potential outcomes associated with late bus runs could engage stakeholders in identifying, assessing, evaluating, and treating the associated risks.

Another opportunity to broaden one's approach to risk management is to incorporate it into existing policies and procedures. Some examples might include project management, the budget process, performance management, management reports to financial rating agencies, and change-management procedures.

## Action Item #7 – Establish Accountability and Performance Measures

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School districts should create performance measures, key risk indicators, and expected outcomes for how risk will be managed and clearly establish who is accountable for those outcomes. Departments such as transportation, food services, facilities, and safety and security utilize explicit performance metrics and are logical places to begin. The risk management group associated with the Council of the Great City Schools has begun to identify common denominators for measuring risk-management performance and build upon the preliminary list of ROI incorporated in this paper.

## Action Item #8 – Look Ahead

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Where does your district need additional coordination or communication about identifying and dealing with risk? School districts should establish greater collaboration between risk management activities and internal audit or similar functions within a district. Internal audit, for instance, serves an important function in ensuring that risk management is addressing a broad array of risks and contributing to successful outcomes. This may also include the review of key performance indicators and business management processes.

ERM integrates consideration of risk into decision making at all levels of the organization. For a mature program, the risk management process should be integrated into key organizational processes such as strategic planning, performance and process management, internal control, compliance, and governance.

## Conclusion and Call to Action

We live in a world of uncertainty where the need for risk management has never been greater. Implementing ERM can help districts navigate that uncertainty. It provides a framework for strategic thinking, consistent management, continual improvement, and communication. It also specifies a process for assessing risk that supports strategy, goals and objectives. ERM is a practical model that helps prioritize all risks and brings focus to decisions and activities. Over time, implementing ERM will build resilience and preparedness for all stakeholders.

It is important to recognize that ERM is an emerging practice among businesses, public entities, the federal government, and school districts in the United States. The ERM approach to managing risk is far-reaching and growing in support. For public school districts, implementing ERM can be a low-cost, high-yield strategy that improves the chances that we'll be able to achieve our most important goal—the education of the next generation.

## Appendix A: Best Practices

Best Practices for a large urban school district to define and measure ERM performance:

- ✓ The Risk Management function is at a senior staff level and reports directly to a cabinet level position within the school district.
- ✓ The school district creates an annual strategic plan, which includes wording to capture the upside and downside of risk (or opportunities and threats) as it pertains to the strategic plan.
- ✓ Newly created school district initiatives are evaluated from an ERM perspective, using a consistent risk analysis process to identify, prioritize, and manage potential threats and opportunities, assign risk owners, and track treatment. The ERM perspective considers the values and perceptions of key stakeholders and plans for communication, monitoring, and the review of key risks.
- ✓ Risk Management goals are set and evaluated annually to assure support of the school district's mission and vision statements.
- ✓ Risk Management discussions are included in cabinet meetings to assure that key internal stakeholders (for example, transportation, food services, facilities, special education, safety and security) are identifying and controlling risks within their respective operations.
- ✓ The school district's audit function coordinates with the district's ERM program to audit prioritized risks and shares responsibility with the Risk Management function to assure successful outcomes.
- ✓ Risk Management monitors and documents the results of the school district's ERM program by reporting out to regulators, financial agencies, and other outside organizations and stakeholders.
- ✓ The school district has established specific return-on-investment (ROI) criteria for the creation and sustainability of its ERM program in order to benchmark and report on results.





Council of the Great City Schools  
1301 Pennsylvania Ave. N.W.  
Suite 702  
Washington, D.C. 20004