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Trustee Brief

Governance Risk: What Trustees Need to Know

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“Serving on boards has never been more challenging. Directors are expected to know more, do more, and take more responsibility for more areas of oversight than ever,” stated the 2006-2007 Heidrick & Struggles 10th Annual Corporate Board Effectiveness Study.[1] Those words are even truer today than they were five years ago. But do the increased challenges, complexity, scrutiny and responsibility mean that governance is a risky business? Risk, by definition, implies the chance of possible loss or other negative consequence. Boards and trustees who pay attention to the fundamentals of fiduciary duties and shoulder the responsibilities entrusted to them can minimize risk and focus instead on the valuable service they provide to their organization and community.

Health care is a complex, heavily regulated business. The pace of change in the health care environment continues to accelerate, spurred even faster as the varied components of the Patient Protection and Affordable Care Act go into effect. Confronting financial concerns and responding to market competition and regulatory change have added to hospital boards’ already significant responsibilities.

Where’s the Risk?

Exempt from taxation, not-for-profit hospitals are held to a standard of fulfilling their charitable mission. Yet perceptions, allegations, and findings of insufficient charitable care or community benefit, excessive executive compensation, over-zealous billing and debt collection practices, and lack of transparency have resulted in intense scrutiny by the media, the public, policymakers and regulatory authorities. The courts have clearly established the board’s accountability for the fulfillment of fiduciary duty and obedience to the organization’s mission. In fact, the Internal Revenue Code’s “intermediate sanctions” law, which governs excess executive compensation, allows for individuals serving on the board to be held personally accountable for compliance.[2] In the court case, *Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996), the courts established the board’s responsibility for oversight of an organizational compliance plan.[3]

Ensuring compliance is not a simple task. Hospital regulating authorities are many, including, but not limited to, The Joint Commission, the Office of Inspector General, the U.S. Department of Health and Human Services/Centers for Medicare & Medicaid Services, the Internal Revenue Service, Department of Justice, bond ratings agencies, and state regulating authorities. Trustees must be adept at understanding what their accountabilities are and how to best maintain oversight and monitor organizational performance, not only to ensure organizational success and viability, but to minimize risk and best serve patients.

What are the Board's Responsibilities?

At the core of the board's oversight responsibilities are the fiduciary duties of care, loyalty and obedience. To help boards understand and carry out their responsibilities for compliance and mission fulfillment, the OIG, DHHS, and the American Health Lawyers Association have jointly issued three publications: "Corporate Responsibility and Corporate Compliance," "An Integrated Approach to Corporate Compliance," and "Corporate Responsibility and Health Care Quality: A Resource for Health Care Boards of Directors."[3,4,5] Each publication centers its focus on trustees' duty of care. The duty of care requires trustees "to act in good faith, with the care an ordinarily prudent person would exercise under similar circumstances." Further, trustees must act "in a manner that they believe is in the best interest of the corporation."[3] Understanding and carrying out the duty of care is essential to the management of governance risk.

What's in a Compliance Program?[6]

The OIG has consistently identified seven elements for inclusion in compliance programs: a compliance plan, a designated compliance officer, employee training and education, anonymous reporting and/or hotline, response systems, corrective actions, and audits.

To effectively oversee the organization's compliance at all levels, trustees need to be knowledgeable about both the structure and the operations of the compliance program, and ensure the components of a sound compliance program are in place. They must ensure that reporting is enabled, and individuals making complaints are not retaliated against; that audits are conducted and effective corrective action plans are implemented; and that the board monitors progress and outcomes to ensure successful compliance, minimizing exposure to risk for both the organization and the board.

In "Corporate Responsibility and Corporate Compliance," the authors offer a number of questions designed to help boards fulfill their responsibility for reasonable inquiry and to better understand the scope of their organization's compliance program. Examples of these "structural" questions include the following.[3]

- What are the goals of the organization's compliance program?
- What are the inherent limitations in the compliance program? How does the organization address these limitations?
- Does the compliance program address the significant risks of the organization? How were those risks determined and how are new compliance risks identified and incorporated into the program?

The authors also provide questions designed to help evaluate the program's effectiveness and its reporting system. These operational questions delve into the organization's Code of Conduct, policies and procedures, compliance infrastructure, preventive measures and violation responsiveness. Examples of these questions include the following.[3]

- How do we know that the Code [of Conduct] is understood and accepted across the organization?
- Has the organization implemented policies and procedures that address compliance risk areas and established internal controls to counter those vulnerabilities?
- How is the board kept apprised of significant regulatory and industry developments affecting the organization's risk? How is the compliance program structured to address such risks?
- What processes are in place to ensure that appropriate remedial measures are taken in response to identified weaknesses?

Don't Just Sit There.

Boards can't afford to be passive recipients of information if they hope to fulfill their duty of care. Trustees must be actively engaged in the oversight of the organization, including fulfillment of its mission and compliance with laws and regulations.

The OIG, DHHS, and the AHLA advise that courts have interpreted the duty of care to include a level of due diligence that includes "reasonable inquiry" by the board into the organization's operations and performance. In other words, trustees must be prepared to exercise their independence by staying well-informed on issues and actively discussing the potential implications for the organization. Reasonable inquiry also means asking probing questions and challenging the status quo rather than "rubber stamping" pre-determined decisions. To carry out their oversight responsibilities, trustees must ask the questions needed to assure themselves that the board has the information it needs to:

- Make prudent decisions;
- Confirm that the administration carries out its management responsibilities; and
- Ensure the organization complies with applicable laws and regulations.

The OIG, DHHS and AHLA do ***not*** advise trustees to initiate "witch-hunts" or "ferret out" corporate wrongdoing. In the absence of any indication of wrongdoing, the board can expect to rely on the administration in carrying out its duties; however, if suspicions are aroused or there is any indication of impropriety, the duty of care escalates the demand that trustees conduct reasonable inquiry and investigation into the situation.[3]

Quality Fraud.

In "Corporate Responsibility and Health Care Quality: A Resource for Health Care Boards of Directors," the OIG underscores its expectation that health care boards exercise general supervision and oversight of quality and patient safety, including the following.[5]

- Awareness of quality issues, challenges and opportunities;
- Close attention to the development of quality measures and reporting requirements (including periodic education from executive staff); and
- Receipt of executive updates regarding quality initiatives and associated legal issues.

Trustees should understand that quality of care is increasingly linked to reimbursement, and both the OIG and the DOJ have increased their attention to quality and patient safety. Payment for poor quality is viewed as a false claim, and failure to accurately report quality data may be considered potential fraud. Further, both the OIG and the DOJ place the responsibility for quality of care squarely on the shoulders of the board. Once again, the OIG and the AHLA emphasize the critical importance of the board's use of "reasonable inquiry" in the oversight of the organization's quality performance and present a number of comprehensive questions for board use.

Establish a "Rebuttable Presumption."

Among the board's most important responsibilities is the evaluation of the CEO's performance and setting of appropriate compensation. The "intermediate sanctions" law allows the IRS to penalize individuals who approve or receive "excess benefits." Excess benefit applies if the CEO's compensation and benefits are found to be inconsistent with fair market value. The intermediate sanctions law provides for a "rebuttable presumption," the assumption that something is true unless it can be proven otherwise. In this case, the rebuttable presumption is that a CEO's compensation is reasonable and consistent with fair market value *if*:

- The hospital's board of trustees reviews and approves executive compensation, and all of the trustees participating in the review are free from any conflict of interest;
- The board determines the reasonableness of the compensation as part of their review process, using *reliable* comparability information such as independent compensation consultants; review of Form 990 responses filed by other organizations; or compensation surveys or studies; and
- The board maintains contemporaneous, detailed

documentation regarding the review and approval of the executive's compensation.

When setting executive compensation, the board can manage its exposure to risk with attention to these provisions.[2]

Board Knowledge and Skills

Developing a comprehensive succession plan is another means by which the board can help to manage governance risk. Evaluating the board's composition and seeking out new members who can fill governance gaps in knowledge, skills, and expertise to enhance the board's diversity are first steps. Trustee candidates should be ready participants, with the ability to analyze issues and the confidence to ask insightful and challenging questions. A comprehensive orientation and ongoing board education are essential contributors to the board's ability to fulfill its governance responsibilities and fiduciary duty to the organization.

Trustees who are armed with a clear understanding of their fiduciary duties, including reasonable inquiry, and who are engaged, active and accountable board participants, should be ready and able to manage governance risk and focus on their service to the hospital and the community.

Avoiding Conflicts of Interest

The board has a fiduciary duty to ensure that all governance deliberations and decisions are carried out without conflict of interest, always with the best interests of the hospital at the forefront. Hospital leaders who create and adhere to a strong conflict of interest policy will be successful in ensuring open and honest deliberation.

A conflict of interest exists when a board member, senior leader or management employee has a personal or business interest that may be in conflict with the interests of the hospital. A "red flag" should be raised any time the personal or professional concerns of a board member may affect his or her ability to put the welfare of the organization before personal benefit.

Conflicts of interest can be complicated, and are almost always unintentional. In some cases no conflict actually exists, but the perception of a conflict of interest can be just as detrimental. Having multiple systems in place to safeguard against conflict of interest ensures hospitals will minimize personal dilemmas covering a variety of issues, such as financial gain or business or family benefits. These safeguarding procedures will help the hospital and its board to be prepared when real or perceived conflicts do occur.

Boards should establish a process for preventing and addressing the inevitable conflicts that arise, and ensure that conflict of interest policies and procedures are consistently adhered to. Ensuring that a comprehensive conflict of interest policy is in place that requires full disclosure is a critical first step; strictly enforcing the policy is the most important aspect of eliminating conflict.

Every trustee should annually complete a conflict disclosure statement. While a conflict of interest policy defines what potential conflict is, the disclosure statement is the mechanism for individuals to declare any potential conflicts they may have.

Elements of a Compliance Program

The OIG has consistently identified the following elements for inclusion in a compliance program.[6]

- a compliance plan
- a designated compliance officer
- employee training and education
- anonymous reporting and/or hotline
- response systems
- corrective actions
- audits

Sources and More Information

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