

BoardBrief

Knowledge Resources for Governing Effectiveness

Governance Risk: **What Trustees Need to Know**

“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. Those words are even truer today than they were then. 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 in 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 by the Patient Protection and Affordable Care Act (ACA). 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, policy makers 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 (OIG), U.S. Department of Health and Human Services/Centers for Medicare and Medicaid Services (DHHS/CMS), the Internal Revenue Service (IRS), Department of Justice (DOJ), 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. Regulating authorities advise that boards should pay particular attention to areas most at risk for fraud and violation, including referring relationships, billing and claims, privacy and security, and quality-related events.⁹

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, HHS, and the American Health Lawyers Association (AHLA) have jointly issued three publications: 1) *Corporate Responsibility and Corporate Compliance*, 2) *An Integrated Approach to Corporate Compliance*, and 3) *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.

In April 2015, the OIG, HHS, AHIA, Association of Healthcare Internal Auditors (AHIA), and the Health Care Compliance Association (HCCA) issued the publication *Practical Guidance for Health Care Governing Boards on Compliance Oversight*. The publication was developed to provide boards with practical tips and guidance as they carry out their responsibilities for oversight of the organization's compliance with the laws and regulations governing health care.

What's in a Compliance Program? The OIG has consistently identified seven elements for inclusion in compliance programs: written policies, procedures and standards of conduct, a designated compliance officer and compliance committee, employee training and education, effective communication – including anonymous reporting systems and/or hotline, consistent monitoring and auditing, enforcement of standards, and responsiveness to concerns and violations with corrective actions.^{6,10}

To 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. An effective system of reporting alerts the organization to potential violations, helps to keep the board informed of compliance concerns and issues and should be considered a key component of the organization's compliance plan. In addition, the board must also ensure that individuals making complaints are not retaliated against, that audits are conducted, and that corrective action plans are implemented. The board must monitor progress and outcomes to ensure successful compliance and minimization of 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: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: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?

The tips and guidance offered in the OIG's 2015 *Practical Guidance for Health Care Governing Boards on Compliance Oversight* were developed to help boards ensure:⁹

- Clearly defined roles, responsibilities and relationships between the functions of compliance, legal and audit;
- Effective reporting systems and processes;
- Identification of areas of risk, fraud and violation; and
- A sense of accountability for compliance that permeates the organization.

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. Trustees' knowledge and understanding of compliance and the regulatory environment is critical to fulfilling their responsibilities. Compliance should be a key component of the board's governance education program and boards should ensure they receive regular compliance updates and reports from management.

The OIG, HHS, and the AHHA 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, HHS and AHHA 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: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 AHHA 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

Key Players in Compliance

While compliance should be considered the responsibility of everyone connected with the organization, there are several functions with primary responsibilities for legal and regulatory compliance, including compliance, legal, audit, human resources, risk management and quality. The structure, roles, and responsibilities for each should be clearly defined and should account for identification and investigation of risks and violations, and the implementation of corrective action plans. The OIG advises that the compliance officer should not be the organization’s legal counsel or be subordinate to the legal counsel. Similarly, internal audit should also be independent of compliance and legal functions. However, communication, cooperation and collaboration should top the expectations of individuals responsible for carrying out these functions.⁹

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 add legal, regulatory or compliance expertise should be considered. Alternately, the board may consider periodically seeking the advice and consultation of a compliance professional. Trustee candidates should be ready participants, with the ability to analyze issues and the confidence to ask insightful and challenging questions.

Ongoing regulatory and compliance education is essential to the board's knowledge and awareness of regulatory requirements, potential areas of risk, components of

compliance plans and ability to exercise its responsibilities for oversight of the hospital or health system's legal and regulatory compliance. Legal and regulatory authorities expect all boards to make a "meaningful effort" to ensure the adequacy of their organization's compliance plan is commensurate with the size, scope and resources of their organization.

Trustees armed with a clear understanding of their fiduciary duties, compliance responsibilities and established reporting and oversight mechanisms, 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.

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Illinois Office

332 S Michigan Ave

Chicago, IL 60604

630-613-7580

blorsbach@governwell.net

Oregon Office

31090 SW Boones Bend Rd

Wilsonville, OR 97070

503-694-8539

larry@governwell.net

governwell.net