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Projected Governance Trends for Nonprofit Hospitals and Health Systems

A review of current developments has led me to the following perspective on governance trends for 2011:

1. **Reform-Related Diligence.** The complex regulatory and financial changes prompted by health care reform present the board with an unprecedented fiduciary challenge, to which the law expects the board to respond. The board must exercise an enhanced level of attentiveness as it works with management to evaluate (and implement) reform-prompted strategic initiatives. Board attention must not be diverted by urgent daily/tactical issues from the need to focus on long term organizational viability.

2. **Compliance Oversight.** Substantially increased government enforcement activity, and a new emphasis on individual accountability, will place additional pressure on the board's exercise of its *Caremark* obligations. The board will be expected to monitor the continued effectiveness of the compliance program, and the emergence of new compliance risks. Particular focus should be on increasing board sensitivity to "yellow" and "red flag" developments.

3. **Standard of Conduct.** While case law continues to support application of the business judgment rule, it will not provide the board with "bullet proof" protection in matters involving alleged conduct that goes substantially beyond negligence; *e.g.,* conscious inattentiveness, financial impropriety, excessive deference/reliance, self dealing, and waste of assets. Emphasis should be placed on board processes that support enhanced decision-making, especially in connection with major corporate transactions.

4. **Conflicts of Interest.** The vigor of the board's conflicts of interest practices requires close examination as regulatory, media and public tolerance evaporates for perceived ethical lapses. Greater emphasis should be placed on the adequacy and timeliness of individual disclosure, and on conflicts risks arising from both relationships between board members, and non-financial relationships. The appropriateness of "director-as-vendor" arrangements should be reviewed.

5. **Independence.** The board must be increasingly attentive to the critical regulatory importance attributed to director independence in all aspects of governance affairs. This is particularly the case with respect to the composition of the board and of key committees (*e.g.,* governance, audit, compliance, executive compensation), board/management relationships, transaction review and oversight of executive performance. Greater emphasis should be on applying "constructive skepticism" to management proposals.

6. **Executive Compensation.** Governance should anticipate the potential for media, regulatory, medical staff and constituent "pushback" as retirement and deferred compensation arrangements approved pre-recession are disclosed on the Form 990. The risk is that some of these arrangements will seem excessive in the context of the current volatile environment. The executive compensation committee in particular should be proactive in its re-evaluation of these arrangements, and position an organizational response.

7. **Physician Compensation.** The board should consider asserting more direct oversight of critical physician compensation issues and arrangements. This is particularly important given the rapid conversion of private medical practice to hospital employment, and regulatory scrutiny of aggressive forms of physician compensation arrangements. Establishment of a board-level physician compensation focus offers substantial compliance and financial benefits.

8. **Enterprise Risk.** The board as a whole should commit to a practice of identifying, evaluating and managing risk, for all its dimensions. This includes an active assessment of internal controls designed to monitor business risk and competitive threats, and to preserve charitable assets. Such enterprise risk activities should be carefully constructed so as not to marginalize the compliance program, nor to be buried administratively within the many tasks assigned to the audit committee.

9. **Audit Committee.** The transitional economy, health care reform, recent regulatory developments and increasing incidents of fraud committed against nonprofits combine to substantially affect expectations of audit committee performance. Special care should be taken to protect the audit committee from becoming a "dumping ground" of disparate governance duties and tasks. The board should work with committee leadership to evaluate the need for change in the best interests of the board's audit oversight function.

10. **Board Structure, Size.** The current transitional health care environment warrants re-examination of board size, composition and use of committees. It is appropriate to challenge traditional governance structure assumptions and to consider alternatives that offer increased oversight, efficient processes and diversity of perspective. Excess delegation to the executive committee should be avoided. Nomination screening should concentrate on qualifications, time commitment, independence and fitness to serve.

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