Trustee®

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Physician Compensation

# How trustees can improve alignment by overseeing physician compensation

**Trustees need to understand the rules and arrangements of physician compensation so health systems can better integrate and the risks of compliance be reduced.**

**By Marc Hallee and Kevin Wilson**

Relationships between health systems and physicians have undergone significant change in recent years as the health care field transforms into a value-based system of quality, patient satisfaction and cost effectiveness. As health care organizations seek the clinical integration necessary to deliver on this new model, their alignment strategies with physicians have expanded to include a broad continuum of independent and combined approaches from clinically integrated networks and joint ventures to professional service agreements and full employment.

For the hospital or health system board of trustees, these enhanced integration models come with additional responsibilities. Key among them is greater oversight of physician compensation to ensure its alignment with the system's strategy and to comply with any number of federal and state regulations.

Although trustees may be well-versed in overseeing compensation of executive leadership, governance of physician compensation brings a different set of challenges, especially with regard to risk. Health care organizations may be vulnerable to large penalties for violations of regulations about physician compensation even if the board follows a governance process regularly used for decisions on executive compensation.

In order to fulfill their roles as overseers of a health care organization's financial relationships with physicians, trustees must have a comprehensive understanding of the rules and regulations for physician compensation arrangements and the structures in the health care organization that have authority over these arrangements. By following a set of best practices for oversight of physician compensation, including creation of a strategically aligned physician compensation plan, trustees can mitigate financial and reputational risk to the organization.

## Confronting challenges

As clinical alignment strategies proliferate, there clearly is greater need to provide oversight of physician compensation. SullivanCotter's 2015 Physician Compensation and Productivity Survey shows approximately 30 percent of boards have a dedicated physician compensation committee at the hospital or system level. This percentage is consistent with the health care compensation consultants' 2014 survey, but we also have seen a number of very large health systems begin work on physician compensation governance projects. The increase in activity by large systems may indicate a broader trend, one trustees should consider following in their own organizations in light of the significant risk these arrangements can create.

The challenge for many trustees who are experienced in executive compensation but new to physician pay is appreciating the complex regulatory framework that governs it. The enforcement climate is increasingly focused on fair market value and commercial reasonableness in compensation approaches through regulations such as the Stark law, Anti-Kickback Statute, False Claims

Act and Internal Revenue Service tax-exemption rules, in addition to insurance and anti-trust laws.

The financial penalties for violations of federal regulations relating to physician compensation are staggering and have grown dramatically in recent years. According to the Department of Justice, in fiscal 2015, the government recovered $2.4 billion as a result of judgments, settlements and additional administrative impositions in health care fraud cases and proceedings. Since its inception in 1997, the Health Care Fraud and Abuse Control Program has returned more than $29.4 billion to the Medicare Trust Funds, with some settlements exceeding $100 million. Whistleblowers who bring these cases to the government have been awarded millions of dollars as their share of settlements.

In addition to the potential for millions of dollars in damages, health care organizations must dedicate human resources to addressing these issues and, if found in violation of regulations, can suffer harm to their reputations in the professional world and the community at large.

Many of these cases center on health systems paying compensation that regulators consider payments for referrals from the physician to the system. While this may seem counterintuitive to some business leaders, the regulations that govern physician compensation preclude a health care organization from paying a physician in a manner that takes into account the volume or value of referrals or other business generated between the parties.

## Forging alignment

In addition to mitigating financial and reputational risk, a well-structured process for overseeing physician compensation gives trustees the opportunity to ensure that compensation plans align with new value-based goals that are becoming a greater part of the overall strategy of many health care organizations. Establishing a consistent compensation philosophy that covers physicians and executives, including consistent goals based on quality and patient satisfaction, will help an organization increase the value it provides patients and communities.

The following best practices can help trustees better understand and mitigate the compliance risk inherent in physician compensation while also helping the organization develop a comprehensive and consistent compensation philosophy:

**• Establish a physician compensation strategy for the health system.**

As clinical integration becomes the prevalent business model, aligning how physicians are incentivized for their care practices with how an organization is reimbursed is critical to its financial sustainability. Compensating physicians under a fee-for-service model while agreeing to value-based payer contracts is not feasible in the long term. Ensuring that a physician compensation approach is consistent with the organization's overall compensation philosophy and business model will help the organization reach its goals.

**• Create a physician enterprise organizational chart for all parts of the health system.**

Because physicians may receive compensation from different legal entities within one health system — such as a hospital, ambulatory surgery center or medical group practice — it can be difficult to identify the hierarchy of authority over physician groups. This can cause problems when questions or issues arise. A chart showing the different physician entities in a health system will more easily identify for trustees the various financial relationships between physicians and the system.

**• Identify and document the governing body responsible for each entity.**

Governance issues represent points of risk to the organization, so it is critical to have strong oversight for each physician group, both employed and affiliated. Before trustees can develop an appropriate governance structure for a particular system, however, they should first understand the responsibilities of the governing bodies in that hospital, medical practice group or other health system entity.

**• Document the types of physician relationships at each entity.**

Again, health systems are often composed of multiple legal entities with differing financial structures for physician groups. A group of physicians may be directly employed by the hospital or employed through a medical group. A board of trustees should understand these different legal and organizational structures — whether physicians are employed or affiliated, for instance. Knowing the financial relationship between the health system and the physician group will provide trustees with a better understanding of the risk exposure involved in each relationship.

**• Determine and document which body has physician compensation oversight responsibility at each entity in the health system.**

Trustees need to understand who is overseeing compensation arrangements for each physician in a health system to make sure the oversight is sufficiently independent and capable. A hospital CEO, for instance, should not provide sole oversight of physician compensation practices, because he has a vested interest in the business that physicians refer to the hospital. Likewise, a single board of trustees is often not sufficient to oversee physician compensation practices for all the various entities in a health system, especially larger systems that may have dozens of hospitals and physician groups. In each situation, a structure, such as a physician compensation committee, can focus on the compensation issues relevant to a specific entity, physician group or market without the financial bias of an executive and without having responsibility for an entire health system.

Creating a document detailing these responsibilities, including applicable policies approved by the governing body, can help eliminate confusion if something require attention. Also, the documentation helps those accountable understand their responsibilities and create processes to execute the agreed-upon policies.

**• Educate boards, committees, and physicians on physician compensation issues (including the health system's compensation philosophy) and responsibilities.**

Trustees cannot provide appropriate oversight if they do not understand the regulations governing physician compensation. Because this responsibility is new for many trustees, they require education on the rules and issues that are specific to physician compensation arrangements. Likewise, physicians who are more familiar with private practice compensation may not be fully aware of the issues that can arise with employed or aligned compensation structures, so they, too, must be educated. Education can be provided through in-house or external legal expertise or through the entity that provides physician compensation expertise.

**• Conduct regular audits of entity boards and committees to ensure compliance with charters.**

A charter will stipulate rules set up by the governing body, such as a physician compensation committee, that oversees physician compensation. A charter, for instance, may stipulate that decisions regarding compensation that exceeds the 75th percentile of a physician's peers require documented third-party opinions on fair market value. Periodic audits can check whether actual compensation practices conform to the governing entity's charter. In this example, the audit would consist of a review of a random selection of physicians; those whose compensation exceeded the 75th percentile would need documented evidence supporting the FMV of their compensation. If there was no documentation, the system might have exposure to paying a physician outside FMV requirements, and appropriate actions would need to be taken. The audit can be conducted internally, by a risk compliance group or through outside expertise.

### Trustee Takeaways

Here are five questions for boards to consider in developing structures for physician compensation governance:

**1.** What is the risk to the system if there is a compliance problem?

**2.** Are some physician relationships exclusive to a particular entity in the system?

**3.** Is it reasonable for the health system board to handle governance of all physician relationships?

**4.** Can the governance process be tiered or divided?

**5.** Can the system board effectively audit all of the entity boards in the system?

## A new world

The transformation of health care is changing the roles of many stakeholders, from CEOs and other leaders to physicians and even patients. The resulting additional responsibilities for trustees come with a new set of challenges. By following best practices that aim to mitigate risk rooted in physician compensation and by cultivating alignment in compensation approaches, trustees have an opportunity to strengthen the ability of health care organizations to weather change and thrive under value-based care.

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