

Board Oversight of Executive and Physician Compensation

An Update on Key Practices and Protocols

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SullivanCotter is the leading independent consulting firm serving healthcare and mission-driven organizations. Through industry-leading workforce intelligence and specialized advisory expertise, the firm helps organizations assess their workforce, improve organizational structure, align compensation, benefits, and rewards, and accelerate workforce and organizational performance. By integrating data analytics, behavioral science, and deep industry insight, SullivanCotter aligns strategy with structure and reimagines the definition of partnership, working alongside leaders to architect the future of healthcare and build organizations better equipped to serve their communities.

McDermott Will & Schulte is a leading international law firm. With more than 30 years of experience serving the healthcare industry, its team counsels leading organizations in every major sector of the health industry on workforce management, regulatory, and business transaction issues. Its Health Industry Advisory Group is the only health practice to receive top national rankings from *US News–Best Lawyers* “Best Law Firms,” *Chambers USA*, *The Legal 500 United States*, and *Law360*.

The Governance Institute

The Governance Institute provides trusted, independent information, tools, and resources to board members, healthcare executives, and physician leaders in support of their efforts to lead and govern their organizations.

The Governance Institute is a membership organization serving not-for-profit hospital and health system boards of directors, executives, and physician leadership. Membership services are provided through research and publications, conferences, and advisory services. In addition to its membership services, The Governance Institute conducts research studies, tracks healthcare industry trends, and showcases governance practices of leading healthcare boards across the country.

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Introduction

Oversight of executive and physician compensation is widely recognized as a fundamental obligation of not-for-profit hospitals and health systems. This oversight obligation arises from the board’s fundamental fiduciary duty of care. In not-for-profit hospitals and health systems, the board is accountable for ensuring organizational resources are used prudently, executive and physician compensation is reasonable and defensible, and pay practices align with the organization’s charitable purpose and strategic objectives. Because compensation decisions can materially affect financial sustainability, regulatory compliance, tax-exempt status, public trust, and organizational culture, they fall squarely within the board’s governance responsibilities. As stewards of the organization, directors must exercise independent judgment, rely on appropriate data and expertise, and ensure compensation arrangements are structured to support performance, integrity, and mission advancement rather than personal benefit.

This toolkit is intended for:

- ✓ Boards and board leaders
 - ✓ Members of the board-level compensation committee
 - ✓ CEOs and senior leaders
 - ✓ General counsels
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The compensation of both senior executives and physicians has historically been subject to significant public monitoring as it relates to an organization’s not-for-profit status, the rising costs of healthcare (and health insurance), retention of highly qualified executives and physicians, access to care concerns, compensation-related laws and regulations, and the broader acceleration of leadership compensation across industry sectors. As a result, levels of executive and physician compensation—and the internal processes by which they are established—are subject to close scrutiny by state and federal regulators, the media, insurance companies, competitors, and healthcare consumers.

All of these factors and more combine to substantially increase the level of engagement expected from healthcare governing boards in compensation decision making. To address this, many organizations have established a board-level compensation committee to oversee executive and, to some extent, physician compensation decisions. Whether the compensation committee acts with advisory or delegated authority is a decision that requires careful consideration and an awareness of the legal, regulatory, and structural factors. The nature of the entity (e.g., stand-alone or part of a larger system) plays an important role as well. In all situations, it is recommended that the full board be familiar with the details of specific compensation packages, especially those of highly compensated individuals, and with the rationale and arguments supporting them.

The goal of this toolkit is to provide up-to-date guidance on how a not-for-profit healthcare organization and its governing board should best proceed to address executive and physician compensation issues. Specifically: 1) to provide an awareness of the breadth of the current regulatory focus on executive and physician compensation of not-for-profit organizations; 2) to review what the law provides and allows with respect to such compensation; and 3) to provide a “roadmap” for organizations, governing boards, and compensation committees to organize compensation decision-making processes to address recruitment and retention needs while fully complying with relevant law and practice.

Key Industry Trends

A comprehensive review of the governance aspects of executive and physician compensation processes is best supported by awareness of key industry trends in this area. Such awareness helps board and compensation committee members appreciate the continuing relevance of, and the degree of third-party attention to, the compensation determination and related processes.

Need to Know: Emerging Trends for the Compensation Committee

Establishing reasonable yet competitive compensation levels for executives can be challenging in today's environment. What may be considered reasonable by some stakeholders may not be competitive with contemporary market practices for qualified and experienced executives. Further complicating matters, talent markets in very large not-for-profit health systems have blurred and entered for-profit markets, where significantly higher compensation levels may be offered, given the ability to provide equity opportunities. Additionally, increased complexity, spans of control, and consolidation have led to higher executive compensation to address talent market needs, especially as health systems have become among the nation's largest employers.

Trends Snapshot: Executive Compensation

- ✓ Blurring of not-for-profit and for-profit talent markets
 - ✓ Increasing organizational complexity and spans of control
 - ✓ Rising regulatory and public scrutiny of executive pay
 - ✓ Greater emphasis on performance alignment and talent risk
 - ✓ Evolving executive skillsets (digital, workforce, transformation)
-

Organizations must balance compliance-related aspects (i.e., reasonableness of compensation) with "real-world" governance responsibilities to attract, retain, and reward a talented and capable executive team. This requires skilled board members serving on the compensation committee to follow best-in-class governance practices to evaluate talent risk and design programs that meet a variety of needs: compliance, market competitiveness, performance, leadership development, and succession planning.

Since performance is a key factor in determining executive pay, evaluating and setting expectations is a critical role of the compensation committee. Today's environmental challenges have increased the likelihood of significant volatility in healthcare, given the headwinds on the horizon (e.g., higher labor and supply chain costs, impact of the One Big Beautiful Bill Act [OBBBA] on reimbursement, site-of-care shifts, rising demand for healthcare given the aging of the U.S. population, and expected shortfalls in physician and nursing supply in the midst of increasing demand). Artificial intelligence (AI) will be both an enabler and a disruptor in this environment, with a significant impact on human capital.

Compensation is a tool the board can use to drive performance outcomes in the areas of quality, safety, patient and employee experience (both clinical and non-clinical), access, and financial sustainability. Programs may be designed to drive longer-term efficiency,

growth, mission-related, and strategic objectives to address the headwinds facing healthcare. Talent markets and required executive skillsets will evolve in response to these challenges, requiring leaders who can address operating model redesign, digital and technology needs, physician alignment, labor productivity management, and change leadership. Organizations need compensation committees to lead the way in setting expectations regarding performance and its alignment with executive pay.

Additionally, the following trends are expected to dominate the executive compensation-related public policy debate, regulatory initiatives, and organizational decision making in the near future:

- **Public and policy scrutiny is increasing:** With greater frequency, particularly at the state level, policymakers are expressing concern with what they perceive as excessive compensation for executives, administrators, and managers at not-for-profit health systems, hospitals, and medical groups. There remain elements within legislative bodies, regulatory agencies, and the media that perceive public policy as requiring executives of not-for-profit organizations to accept a discounted level of compensation. This has led to increased taxation on executive compensation, greater scrutiny, and calls to cap healthcare executive pay.
- **Board oversight expectations are rising:** From a public policy and regulatory perspective, effective board oversight of executive compensation is increasingly viewed as fundamental to not-for-profit, exempt organization status. Thus, related legislative/regulatory/media/union scrutiny is unlikely to decrease in the near future.
- **Transparency and reporting requirements are intensifying:** Greater scrutiny has been placed on Form 990 disclosures by the media and regulators, which has increased its importance as a public reporting document, particularly with respect to executive compensation. This, in turn, requires increased organizational resources to complete it.
- **Compliance standards are becoming more rigorous:** Greater focus is being placed upon meeting the Internal Revenue Service's (IRS) rebuttable presumption of reasonableness as a minimum standard. This requires focus on both the independence of compensation committee members and the use of outside compensation advisors.
- **Additional compensation elements are under review:** Secondary compensation components (e.g., discretionary expenditures, travel and entertainment expenses, executive use of corporate assets, country club memberships, split-dollar life insurance) often play a disproportionately significant role in regulatory review.
- **The pace of change is accelerating:** The speed and intensity of new executive compensation-related developments leave little room for organizational complacency with respect to internal policies and procedures. These must be continually revisited to ensure their effectiveness.

Need to Know: Emerging Trends for Physician Compensation

As regulatory scrutiny intensifies, multiple other market dynamics are compelling health systems to evaluate the sustainability of their current provider workforce, with implications for physician compensation and, in turn, creating additional compliance considerations.

By 2030, it is estimated that one in five Americans will be 65 years or older.¹ According to U.S. Census figures, this demographic accounted for 17 percent of the population in 2020 (55.8 million) and is expected to grow to approximately 20 percent by 2030 (estimated range: 73–74 million). These changing demographics will result in significant shifts in healthcare demand. At the same time, across many markets, 23 percent of current physicians will reach retirement age by 2030.² The challenge is particularly acute in specialties like primary care, cardiology, neurology, oncology, and orthopedic surgery. Physician recruitment and retention strategies will become increasingly important for health system leadership.

Trends Snapshot: Physician Compensation

- ✓ Aging population driving increased demand for care
 - ✓ Significant physician retirement risk
 - ✓ Compensation growth outpacing productivity
 - ✓ Intensifying regulatory scrutiny (Stark Law, AKS, FCA)
 - ✓ Ongoing tension between market pressure and compliance requirements
-

An analysis of multiple years of physician productivity data suggests that physicians entering practice today are less productive than established physicians, largely due to different work styles and a desire for greater work-life balance. That said, new physicians expect compensation comparable to that of their established peers and similar ratios of clinical and non-clinical support staff, which further challenges financial and operational sustainability.³

Over the last three years, average clinical cash compensation has outpaced historical annual increases, which have been around 3 percent. More notably, average cash compensation increased by 6 percent in 2025. Over that same period, average clinical wRVU productivity, a common measure of physician productivity, only increased by 1.5 percent on average:⁴

- Although average increases have outpaced historical market norms, there have been larger-than-typical (e.g., double-digit) cash compensation increases in certain specialties, particularly challenged by supply-side pressure. These specialties include, but are not limited to, certain cardiology and radiology subspecialties, anesthesia, neurology, and certain surgical subspecialties.⁵

1 Claritas Pop-Facts®.

2 SullivanCotter's proprietary Provider Needs Assessment.

3 SullivanCotter 2023 to 2025 Physician Compensation and Productivity Surveys.

4 *Ibid.*

5 *Ibid.*

- Pressure to ensure ongoing access to key specialty coverage may require more aggressive compensation strategies, which have the potential to outpace typical market practices. These anticipated market pressures heighten the importance of ensuring compliance processes are effective and efficient.

The 2026 Medicare Physician Fee Schedule (PFS) final rule, driven by the OBBBA, will increase the conversion factor for physician professional services between 3.26 and 3.77 percent, the first increase in six years. The conversion factor adjustment should provide some revenue relief for health systems. That said, CMS has instituted a novel 2.5 percent efficiency reduction in certain physician wRVUs to account for enhanced efficiency in certain non-time-based clinical services. The adjustment will begin in 2026 and occur every three years. The efficiency adjustment should reduce physician wRVUs for specialties with high-volume, short-duration procedures. Organizations will need to closely monitor the tension between market pressure on cash compensation and the reduction in productivity as part of their ongoing compliance efforts.

Over the past several years, regulatory guidance and settlement activity have made clear that physician compensation compliance is squarely in regulators' view, thereby requiring organizations to sharpen their focus on oversight of physician-related compensation.

Evidence of this trend is the enforcement intensity around physician compensation arrangements rising under the federal False Claims Act (FCA), with federal physician self-referral law (Stark Law) and federal AntiKickback Statute (AKS) theories frequently driving hospital and health system risk. States also have their own versions of these federal counterparts. The U.S. Department of Justice reported \$6.8 billion in FCA settlements and judgments in FY 2025, with healthcare remaining a core recovery area (\$5.7 billion) and whistleblowers filing a record 1,297 *qui tam* actions.⁶ Recent Stark Law-based cases alleging above-fair market value (FMV) pay and incentive structures that implicate referral volume, underscore the premium regulators place on demonstrable FMV, commercial reasonableness, and operational guardrails meant to prevent regulatory violations. Even without government intervention, regulators have achieved significant outcomes in physician-related FCA cases, reinforcing that private actions can sustain momentum in this space.⁷

Over the past several years, regulatory guidance has sharpened what is expected for oversight of physician-related compensation. The 2020 Stark Law rulemaking from the Centers for Medicare and Medicaid Services (CMS) clarified several key definitions of applicable exceptions, including commercial reasonableness and FMV/general market value, and introduced tests interpreting volume-or-value correlation.⁸ These are tools that boards and compensation committees can apply to pressure-test physician employment agreements, leadership roles, co-management agreements, and incentive formulas before approval.

6 Office of Public Affairs, "[False Claims Act Settlements and Judgments Exceed \\$6.8B in Fiscal Year 2025](#)," U.S. Department of Justice, January 16, 2026.

7 See e.g., Archives, "[Indiana Health Network Agrees to Pay \\$345 Million to Settle Alleged False Claims Act Violations](#)," U.S. Department of Justice, December 19, 2023.

8 Federal Register, "[Medicare Program; Modernizing and Clarifying the Physician Self-Referral Regulations](#)," 85 Fed. Reg. 77,492 (December 2, 2020).

The Office of Inspector General's (OIG) 2023 *General Compliance Program Guidance* further emphasizes board-level oversight, routine risk assessment, and continuous monitoring of risk areas for healthcare organizations—signaling that physician compensation compliance is not a one-time contracting exercise but a standing component of an organization's compliance program.⁹

Fraud and abuse compliance expectations reach beyond the four walls of the underlying contract into governance process quality and ongoing performance monitoring and documentation. Approval bodies are expected to base decisions on current, market-specific FMV analyses, record how "commercial reasonableness" is satisfied, and ensure compensation terms do not run afoul of state and federal law. Post-execution, organizations are expected to validate that services were actually performed (e.g., director duties/time), incentive outcomes are tracked, and any role or market changes trigger timely updates.

⁹ OIG, *General Compliance Program Guidance*, November 2023.

The Basics of Board Committee Practice

Given that much of the focus of this toolkit is on the responsibilities of the board-level compensation committee, it is appropriate to revisit some of the basic corporate law principles relating to the creation, function, and authority of governance committees.

Corporate law generally does not require the creation of committees; ultimate responsibility for the corporation rests with the board. However, recognized governance principles promote the creation of board committees to address specific responsibilities and enhance overall corporate governance efficiency. The establishment and (to a certain extent) operation of board committees is typically governed by the most applicable state corporation statute. Public disclosures concerning corporate governance should describe the structure and function of each board committee, including, but not limited to, the compensation committee. More to the point:

1. **Authority:** State law (statute and/or common law) generally recognizes the ability of the board to act in part through committees appointed by the board pursuant to its bylaws.
2. **Creation:** The board is typically authorized to create such committees, with such representation from the board, unless the corporation's articles of incorporation or bylaws provide otherwise. Such actions typically require majority board approval.
3. **Delegation:** Committees may be given advisory or delegated authority to act; the former positioning the board to rely on the advice of a committee in making a decision, the latter allowing the board to act on a specific matter on behalf of the board.
4. **Abdication:** Board members do not abdicate their basic duties and responsibilities simply by delegating authority to board committees. Directors must monitor the performance of committees with delegated responsibilities.
5. **Evaluations:** Performance-related evaluations of each committee and of individual committee members are helpful in supporting the board's review of committee performance and individual committee member engagement.
6. **Limitations:** Many state laws prohibit a committee from taking certain specific actions. These limitations/prohibitions often extend to actions such as:
 - Distribution of the organization's assets, or dissolution.
 - Acts that require member approval.
 - Filling board and committee vacancies.
 - Election, appointment, or removal of any officer, director, or committee member, or fixing their compensation.

- Adoption, amendment, or repeal of articles or bylaws.
 - Adoption of mergers or consolidations, or approval of material asset sales.
 - Acting in a manner inconsistent with a board resolution when such resolution provides that it cannot be amended, altered, or appealed by a committee.
7. **Composition:** Most state laws establish a floor or a minimum number of directors (e.g., one or two) necessary to compose a committee and require that in all events a majority of committee members must consist of directors. Such laws allow more flexibility in committee composition to introduce new perspectives and expertise not currently available at the board level.
 8. **Reliance:** Committee members are entitled to rely on information, opinions, reports, statements, decisions, and judgments provided by corporate officers, executives, and qualified outside advisors—subject to certain restrictions.
 9. **Procedure:** State laws often apply to committee functions the same procedural requirements applied to board meetings, actions without meetings, notice and waiver thereof, and matters of quorum and voting.
 10. **Engagement/refreshment/reporting:** In establishing and maintaining committees, the board and its governance committee should give particular oversight attention to such matters as the continued vitality of the committee charter, the composition of the committee, turnover of committee leadership and membership, expectations of director engagement, conflicts of interest and ethics policies, and the frequency and manner of reporting to the full board.

The compensation committee has traditionally had oversight responsibilities for executive compensation. Administrative physician leaders are often included in this group. However, many compensation committees are considering their responsibilities beyond physician leaders and specifically for:

- Other medical leadership positions
- Other highly compensated physicians, regardless of holding a physician leadership position
- Oversight of the FMV and commercial reasonableness compliance process undertaken by management for risk management purposes

Regulatory Fundamentals

Executive and physician compensation paid by not-for-profit organizations is highly regulated at both the state and federal levels.

At the state level, the primary regulator will be the state charities bureau, which is typically located within the office of the state attorney general. The charities bureau typically oversees the operation of not-for-profit corporations and their consistency with the state's not-for-profit laws, including those related to payment of reasonable compensation, consistency with the charitable mission, and the solicitation, investment, and utilization of charitable funds.

At the federal level, the primary regulators are the IRS, with respect to the provisions of the Internal Revenue Code governing Code Section 501(c)(3)-related organizations (including those relating to reasonable compensation and excess benefits) and the Department of Justice and the Department of Health & Human Services, with respect to fraud and abuse and physician self-referral laws.

It is also conceivable under certain circumstances for executive and physician compensation arrangements to implicate certain antitrust and unfair trade practices/restrictive covenant rules enforced by the Department of Justice and Federal Trade Commission.

The Focus of Attention on Executive Compensation

Board members of not-for-profit hospitals and health systems must be attentive to the executive compensation process, as it is currently a "red hot" topic of scrutiny by industry regulators. Both the IRS and state attorneys general are particularly vigilant in this area. These regulators share the same fundamental concern—ensuring that no more than "reasonable compensation" is paid—but approach it through different laws.

States review the issue from the perspective of enforcing the not-for-profit corporation laws (trying to make sure there has not been a "waste" of charitable assets), while the IRS comes at it from the perspective of the requirements of federal tax-exempt status (e.g., Section 501(c)(3)). These requirements allow for the charity to pay no more than "reasonable compensation" to its executives.

BOTH THE IRS and the states expect the governing board to play an active role in the executive compensation process to assure reasonableness, thus protecting charitable assets from waste and assuring that charitable assets will be used to further tax-exempt purposes. In this regard, it is important to recognize that the review and approval of executive compensation arrangements (together with the evaluation of senior executives and succession planning) is among the most important oversight duties of the board of directors of a not-for-profit organization.

For an individual hospital or health system, the IRS is likely to review, among other things:

- The independence of the board or committee members approving the compensation
- The data the board or committee relied upon in approving the compensation (e.g., the extent to which it included information from comparable organizations)
- Whether, in approving the compensation arrangements, the board or committee satisfied all the criteria for the “rebuttable presumption of reasonableness” under the intermediate sanctions rules
- Whether the board or committee (e.g., the compensation committee) reviewed and approved all forms of compensation and benefits paid to those under its purview
- Whether the organization properly reported the compensation on the Form 990

In sum, the IRS will be interested not only in the reasonableness of the compensation arrangement itself, but also in the process by which the organization arrived at its compensation decisions. A huge emphasis is placed on the reliability of comparability data—whether it truly is an “apples to apples” comparison.

Specific Considerations

A. Code Section 4958

Every organization exempt from federal income taxation under Section 501(c)(3) or Section 501(c)(4) of the Internal Revenue Code of 1986 (the “Code”) should ensure that it is familiar with the intermediate sanctions excise taxes under Code Section 4958. If a tax-exempt organization pays unreasonable compensation or benefits, or if the organization provides economic benefits that are taxable but not treated and reported as taxable compensation, **the organization jeopardizes its tax-exempt status and risks the imposition of substantial excise taxes on the recipients of these pay arrangements and on the board members who reviewed and approved the arrangements.**

The Section 4958 rules apply intermediate sanctions excise taxes to “disqualified persons.” These are persons who, at any time in the past five years, can exercise substantial influence over the organization’s affairs—typically the organization’s senior executives. **The focus for such executives is on their “compensation,” which includes all economic benefits provided by the organization in exchange for the performance of services, including all forms of cash and non-cash compensation and all other compensatory benefits, taxable and non-taxable fringe benefits, and expense allowances or reimbursements.** For any item to be considered reasonable compensation under the 4958 rules, the item must at all times be treated as compensation, which, as a general rule, requires that the item be reported as compensation on the Form W-2 (for an employee) or on the Form 1099 (for an independent contractor, including an outside board member).

Significantly, the converse of the foregoing statement is also true. If any item of value is provided to a disqualified person in connection with services provided, and that item is *not* at all times treated as compensation, the IRS will treat that item as an

automatic excess benefit transaction under Section 4958. This “automatic” excess benefit transaction treatment will occur regardless of whether a) the economic benefit is reasonable, b) other compensation the disqualified person may have received is reasonable, or c) the aggregate of the economic benefit and all other compensation the person may have received is reasonable.

The tax on disqualified persons is a two-tiered tax. The initial tax is 25 percent of the amount of the excess benefit. An additional tax of 200 percent of the excess benefit is imposed if the excess benefit transaction is not corrected within the taxable period. This requires the payback of the excess amount. A separate “organization manager” tax of 10 percent of the amount of the excess benefit—up to a maximum of \$20,000 per transaction—applies personally to any organization manager (such as a board member) who knowingly and willfully participated in the excess benefit transaction, unless such participation was due to reasonable cause.

If an excess benefit transaction occurs, two additional consequences must be considered. First, the IRS has the power to revoke the organization’s tax-exempt status. While Congress expressed its intent that the excise taxes be imposed in lieu of revocation of tax-exempt status, in more egregious circumstances, these penalties may be imposed in addition to excise taxes. Second, the organization would be required on its Form 990 annual return to check a box indicating that it is aware of an excess benefit transaction and to provide the IRS with full details of the violation. Such an indication is likely to trigger additional scrutiny.

ONE OF THE most significant aspects of the intermediate sanctions rules is a “rebuttable presumption” that a transaction is not an excess benefit transaction subject to the sanctions if certain requirements are met.

IRS regulations implement this standard by providing that payments under a compensation arrangement are presumed to be reasonable if the arrangement was approved in advance in the following three-step manner:

1. **Approval body:** The arrangement must be considered and approved by the board or by an authorized committee of the board, which in each case must consist entirely of individuals unrelated to and not subject to the control of disqualified person(s) involved in the arrangement. A member of this type of approval body would not be considered to have a conflict of interest with respect to the compensation arrangement being reviewed only if the member:
 - Is not a disqualified person participating in or economically benefiting from the compensation arrangement and is not a family member with respect to such a disqualified person
 - Is not in an employment relationship subject to the direction or control of any disqualified person participating in or economically benefiting from the compensation arrangement

- Does not receive compensation or other payments subject to approval by any disqualified person participating in or economically benefiting from the compensation arrangement
 - Has no material financial interest affected by the compensation arrangement
 - Does not approve a transaction providing economic benefits to any disqualified person participating in the compensation arrangement, who, in turn, has approved or will approve a transaction providing economic benefits to the member
2. **Appropriate comparability data:** The board or committee must obtain and rely upon appropriate data from independent sources as to comparability. Appropriate data may consist of compensation levels paid by similarly situated organizations (both taxable and tax-exempt) for functionally comparable positions, the location of the organization (including the availability of similar employees in the geographic area), independent compensation surveys conducted by nationally recognized independent firms, and actual written offers from similar organizations competing for the services of the disqualified person.
3. **Documentation:** The board or committee must adequately document the basis for its determination (e.g., the record must include an evaluation of the individual whose compensation is being established and the basis for determining that the individual's compensation is reasonable considering that evaluation and data). The IRS has stated that "adequate documentation" means board or committee records that note:
- The terms of the transaction or arrangement that was approved and the date it was approved
 - Board or committee members present during the debate on the transaction or arrangement that was approved and those who voted on it
 - The comparability data obtained and relied on by the board or committee and how the data was obtained
 - Any actions taken with respect to consideration of the transaction or arrangement by anyone who was otherwise a member of the approval body but who had a conflict of interest with respect to the transaction or arrangement

If the board or committee decides that the appropriate compensation for a specific individual position is higher or lower than the comparability data obtained, the board or committee must record the basis for that determination. All this must be done before any compensation is paid.

If these steps are followed and the organization qualifies for the rebuttable presumption, the IRS can challenge the reasonableness of the compensation only by producing probative evidence that rebuts the presumption. This is intended to be a significant burden of proof on the IRS, which further underscores the value of qualifying for the rebuttable presumption.

B. Code Section 4960

Similarly, every organization exempt from federal income taxation under Section 501(c)(3) or Section 501(c)(4) of the Code should ensure that it is familiar with the excise tax that applies under Section 4960 of the Code. Section 4960 imposes, on *applicable tax-exempt organizations*, an excise tax equal to the corporate rate (currently 21 percent), on a) *excess parachute payments* (defined below), and b) *remuneration* over \$1 million (excluding excess parachute payments), that are paid during a taxable year with respect to the organization's employment of a *covered employee*. The tax is imposed on the tax-exempt organization (and related organizations providing a share of the remuneration), not on the recipient. If there is more than one employer, each is liable for its proportion share of the tax. If the employer is a disregarded entity, the sole owner of the disregarded entity is treated as the common law employer under the Section 4960 rules.

Key principles of Section 4960 are:

- An applicable tax-exempt organization includes any hospital or health system that is exempt from tax under Section 501(c) (tax-exempt organization). **However, importantly, parachute payments and remuneration do not include amounts paid to a licensed medical professional for the performance of medical services by such professional.**
- Prior to 2026, every tax-exempt organization had a group of "covered employees" (i.e., the five highest remunerated employees of that organization) for each taxable year of the employer beginning after 2016. However, under the OBBBA, effective January 1, 2026, **the definition of covered employees was expanded to include any employee, or former employee, of an applicable tax-exempt organization or a predecessor who made more than \$1 million by the organization and all related organizations. This could mean a substantial increase in the number of executives and administrative physician leaders included in the definition of covered employees, particularly over time as the \$1 million threshold is not adjusted for inflation.** Independent contractors are not covered unless they are also former employees. Covered employees need not be officers.
- Remuneration means wages subject to federal income tax withholding (which can be less than W-2 pay). Where remuneration is paid by related persons or entities, liability for the excise tax is allocated pro rata among them and in proportion to the remuneration each pays. Remuneration does not include non-Roth contributions to and distributions from a Section 401(a) plan, an annuity plan subject to Section 403(a), a SIMPLE plan under Section 408(p), a governmental Section 457(b) plan, as well as contributions to a non-governmental Section 457(b) plan. However, remuneration includes amounts required to be included in income under Section 457(f). Such remuneration is "paid" when it is no longer subject to a substantial risk of forfeiture. As noted above, parachute payments and remuneration do not include amounts paid to a licensed medical professional for the performance of medical services by such a professional.
- An excess parachute payment is the portion of a parachute payment that exceeds one times the employee's "base amount" (average annual taxable compensation for the preceding five years). A parachute payment is a payment to or for the benefit of a covered employee that is a) in the nature of compensation, and b) contingent on the

employee's separation from employment with the employer. The excise tax applies only if total parachute payments exceed three times the employee's base amount. Parachute payments do not include payments under tax-qualified retirement plans, 403(b) plans, or 457(b) deferred compensation plans.

C. State Issues and Challenges

While public policymakers at the state level express the same fundamental concern—ensuring that no more than “reasonable compensation” is paid—they are guided by different laws. Historically, attempts have been made by state attorneys general and other regulators to press the issue from the perspective of enforcing non-profit corporation laws (to ensure there has not been a “waste” of charitable assets). A recent case from the Pennsylvania Supreme Court issued in 2025 is instructive. In *Pottstown School District v. Montgomery County Board of Assessments Appeals*, the Pennsylvania Supreme Court reversed the lower courts and rejected a claim made by a local board that a health system was not a valid non-profit corporation under state law for purposes of the property tax exemption due to “eye-popping” executive salaries. The court held that the claim of excessive compensation payments should be rejected essentially because the system followed the IRS procedures under Section 4958 for determining reasonable compensation.

THE MAJORITY'S REASONING was, in large part, based on the argument that non-profit hospitals are actors in a broad marketplace and, at the end of the day, need to be able to pay market rates. However, a forceful dissent makes the point that when an executive's salary and bonuses are tied to the hospital's market performance rather than its charitable impact (where the two differ), the non-profit inevitably operates with a profit motive. The two opinions nicely illustrate the tension at the heart of the public policy debate.

D. Other Federal Regulations

Although not directly applicable, non-profit boards and compensation committees should be attentive to new rules on executive compensation payable by publicly traded companies as promulgated by the Securities and Exchange Commission, as well as actions by the Federal Trade Commission, such as the recent attempt to ban executive non-compete provisions (which was vacated in 2025). A principal purpose of the SEC and FTC rules—and one that is relevant to non-profit organizations—is to increase public transparency of corporate compensation arrangements. It is important to note that these rules are often not designed to limit executive compensation, but rather to improve its disclosure. Non-profit boards and their compensation committees are particularly well advised to take close note of significant regulatory initiatives on transparency and disclosure, and not to dismiss them merely because of the nature of the organizations to which they apply.

The Focus of Attention on Physician Compensation

Two federal fraud and abuse laws most often intersect with physician compensation decisions in the healthcare sector: the AKS¹⁰ and the Stark Law.¹¹ The FCA¹² serves as the government's principal enforcement mechanism when alleging violations of the AKS or Stark Law as claims submitted to federal programs that stem from non-compliant physician arrangements may be treated as false or fraudulent, exposing organizations to treble damages and per-claim penalties.

The AKS broadly prohibits offering, paying, soliciting, or receiving anything of value to induce or reward referrals or the purchasing/ordering of items or services reimbursable by federal programs.¹³ Remuneration can include not only a kickback, bribe, or rebate, but also any salary, stipends, bonuses, benefits, or in-kind support. The AKS includes certain regulatory safe harbors adopted by the OIG that protect certain compensation arrangements when all elements are met.¹⁴ Of particular relevance are 1) the bona fide employment safe harbor, which broadly covers compensation to physician or executive employees acting within the scope of employment; and 2) the personal services and management contracts safe harbor, which is often used for independent contractors such as medical directors or management consultants and requires, among other conditions, commercially reasonable scope and remuneration that is fair market value, set in advance, and does not vary with the volume or value of referrals or business otherwise generated between the parties. These safe harbors are technical and must be satisfied in full to confer protection, but provide a clear structuring pathway for employment and contractor arrangements when satisfied. When an arrangement does not satisfy all elements of an AKS safe harbor, it is not deemed illegal, per se. Rather, the arrangement is evaluated under a facts-and-circumstances standard that examines whether one purpose of the remuneration is to induce or reward referrals of items or services reimbursable by a federal healthcare program. In this analysis, the absence of safe harbor protection removes the regulatory presumption of legality but does not create a presumption of wrongdoing.

Strong governance checks include:



Clear Role Definitions

Ensures everyone understands their responsibilities and accountability



Independent Support for FMV

Provides objective valuation and guidance for executive compensation



A Documented Business Rationale

Establishes a clear purpose for the arrangement and supports carefully designed compensation metrics

¹⁰ 42 U.S.C. § 1320a7b(b).

¹¹ 42 U.S.C. § 1395nn and regulations at 42 C.F.R. Part 411.

¹² 31 U.S.C. § 3729(a)(1)(A)–(B).

¹³ 42 U.S.C. § 1320a7b(b).

¹⁴ 42 C.F.R. § 1001.952.

The Stark Law, by contrast, is a strict-liability statute that bars a physician from referring Medicare patients for designated health services (DHS) to an entity with which the physician (or an immediate family member) has a financial relationship, unless an exception applies; the entity is also prohibited from billing for DHS furnished pursuant to a prohibited referral.¹⁵ Stark Law exceptions that are commonly applied to physician compensation arrangements with hospitals and health systems include the bona fide employment exception, the personal services arrangements exception, and the FMV exception—each of which requires commercially reasonable terms, FMV compensation, and that payment not be determined in a manner that takes into account the volume or value of referrals or other business generated. In 2020 rulemaking, CMS clarified the meaning of key terms, including commercial reasonableness and FMV/general market value, and adopted tests for whether compensation “varies with” the volume or value of referrals or other business generated. These are standards that boards can apply when designing physician compensation structures and when approving such arrangements.

Boards should also implement a repeatable, auditable approval process that screens for *common risk features* in physician compensation arrangements. Examples of such features include:

The image contains four colored boxes, each with an icon and text describing a common risk feature:

- Referral-Based Incentives** (Blue box): Incentive metrics that track referral volume or downstream revenue. Icon: A megaphone with three arrows pointing out.
- High Compensation** (Dark Gray box): Compensation levels that appear high relative to clearly defined duties. Icon: A money bag with a dollar sign.
- Weak Documentation** (Green box): Weak or after-the-fact documentation. Icon: A checklist with a pencil.
- Non-Cash Benefits** (Purple box): Non-cash benefits (space, staff, services, or support) provided outside normal payroll that could be considered remuneration. Icon: A dollar sign, a heart, and a person icon.

Outliers can be addressed on a case-by-case basis, often in coordination with third-party consultants.

¹⁵ 42 U.S.C. § 1395nn (a)(1).

Executive Compensation Governance: Best Practices

Compensation committees balance an extremely complex set of financial, operational, talent, and governance factors as they undertake their work. This section provides the following to guide committee activities:

1. Governing documents
2. Executive compensation agenda items
3. Process considerations
4. Committee composition

Effective executive compensation governance requires attention to both compliance and strategy. Compliance seeks to ensure defensible arrangements, while strategy drives the retention, recruitment, reward, development, and succession planning aspects of the program. Governance serves as the structural foundation that integrates these domains.

The Synergy of Compliance and Strategy in Executive Compensation



The Foundation: Governing Documents for the Compensation Committee

The compensation committee should maintain and annually review its governing documents. These include the committee charter and philosophy documents (see samples provided in the Appendix). Committee calendars and governance checklists can help guide the committee and ensure its oversight, as well as serve as important communications to the full board on the committee's activities in fulfilling its duties.

Compensation Committee Charter

The committee charter outlines the committee's responsibilities for all aspects of the executive compensation program, including ensuring competitive yet reasonable compensation. The board-approved charter should clearly outline:

- The purpose of the committee.
- Committee member composition (with particular importance to ensuring disinterested status and no conflicts of members).
- The number of committee meetings per year and the definition of a quorum.
- The executive (and, as applicable, physician) positions that are under the committee's purview.
- The accountabilities and decision rights for the committee. The executive compensation-related items typically include:
 - » Establishing and approving the executive compensation philosophy, including peer groups (see details on the next page).
 - » Approving new or changed executive compensation program elements/design (e.g., annual and long-term incentive plans, supplemental executive benefits, special retention awards).
 - » Approving the performance goals for annual and long-term incentive plans.
 - » Evaluating performance of the incentive goals at year's end and approving the awards.
 - » Reviewing the CEO's performance and determining the CEO's base salary increase, incentives, and other items of total compensation, as well as reaching a conclusion of reasonableness (in some cases, the committee recommends the compensation adjustments for the board's approval).
 - » Approving the CEO's recommendations for base salary increases, incentives, and other items of total compensation, and reaching a conclusion of reasonableness for the other executives within the committee's purview.
 - » Succession planning and talent development for the CEO and other senior executives.
 - » Approving contracts and special arrangements (e.g., severance, retention for the CEO and other executives).
 - » Receiving annual updates on industry, compensation, performance, and talent trends.
 - » Reviewing the Form 990 disclosures.
 - » Documenting its work in timely minutes and regularly updating the board on its activities.

- Delegation of decision making in between meetings (e.g., to the chair, subcommittee).
- Who will support the committee (including executive staff, legal counsel, and consultants).

Compensation Philosophy

The compensation committee should maintain an executive compensation philosophy document that memorializes the guiding principles for its compensation decisions. The philosophy includes:

- Guiding principles for executive compensation decision making.
- Definition of the competitive peers used for comparison purposes (e.g., comparable not-for-profit healthcare organizations; role of general industry; tailored peers for select roles).
- Definition and role of the components of compensation (e.g., salary, incentives, benefits, severance).
- Desired positioning of the elements of compensation and total compensation; the positioning may be a defined percentile (e.g., 50th percentile) or a range (e.g., 50th to 75th percentile, depending on criticality, performance, talent availability, etc.).
- Other considerations (e.g., whether tailored individualized incentives, retention, or benefits may be used; flexibility to provide compensation outside of the desired range when warranted by business or talent considerations, etc.).

Calendar of Activities/Governance Checklist

The compensation committee should develop an annual calendar of activities that follows the responsibilities defined in the charter and ensures the committee fulfills its duties. This calendar serves as a checklist for the committee to review regularly, ensuring its work is completed in accordance with both the charter and the philosophy. A governance checklist can be developed to ensure the committee fulfills its role and responsibilities throughout the year and is reported to the board as part of transparent communications.

Executive Compensation Committee Evaluation Form

The board is well served by evaluating the performance of the compensation committee, its members, and advisors. The stakes of the committee's decisions are increasingly high given the visibility and scrutiny of executive compensation. The board is best served with members who are experienced and attentive to their fiduciary duties on this committee. The charter and the checklist serve as effective tools to evaluate whether the compensation committee is fulfilling its responsibilities. The committee should also periodically assess the performance of its advisors.

COMPENSATION DECISIONS CAN no longer be made in isolation or without some effective and formalized oversight. Effective governance provides the structure required to ensure defensibility, financial stewardship, and strategic alignment.

The Compensation Committee's Agenda

The compensation committee should plan for the following:

Incentive Goals, Performance, and Awards

Incentive goal setting is increasingly complex for health systems as they expand geographically, pursue other businesses, and address near-term and long-term operating priorities. The committee should consider the following as annual and long-term incentive goals are developed at the start of each performance period:

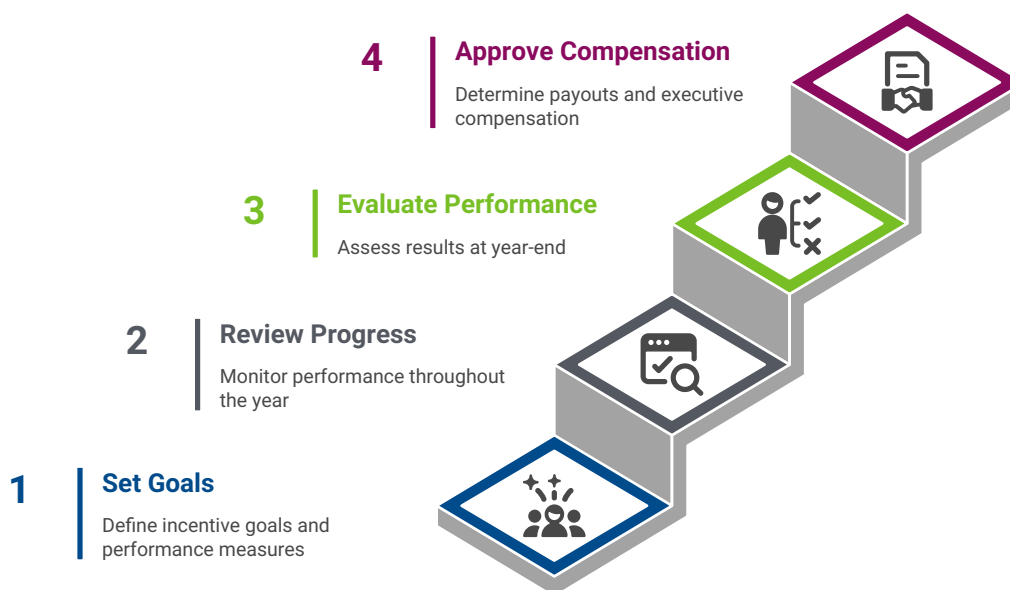
1. **Focus on key performance priorities:** Ensure that incentive goals reflect critical priorities for the near-term and long-term. Annual incentive goals may include financial stewardship (e.g., margin, cost efficiency), quality, workforce engagement, access, growth, and patient satisfaction. Long-term incentive goals typically focus on key multi-year strategic initiatives. Consideration should be given to measures related to community benefit.
2. **Determine balance of enterprise, operating unit/function, and individual goals:** The goals in the incentives should appropriately balance shared enterprise goals for participants versus those tied to a specific operating unit/function or individual performance.
3. **Account for uncertainty in goal setting:** The uncertain and volatile environment creates challenges for performance forecasts. Consider the use of relative performance indicators, validate that the range of performance standards for threshold/target/maximum reflects current uncertainties, and determine if milestone goals are appropriate. Determine the role of discretion in evaluating goal results.
4. **Verify incentive performance standards:** Performance standards should be set to ensure that they reflect appropriate improvement over baseline and that target goals are attainable while representing a reasonable degree of stretch. External validation should be used where possible.

The organization's management will propose incentive goals, and the committee will deliberate and approve the goals. A best practice is to set goals over two meetings:

1. To preview the goals and performance measures for committee feedback and direction
2. To present final goals and performance measures as well as the performance metrics for approval

During each meeting throughout the year, the committee should receive status updates on performance versus the goals. Following the close-out of the performance cycle, the committee will determine and approve final performance results and the corresponding incentive payouts based on management's presentation of the results. As award decisions are made, the committee should determine the appropriate role for discretion—this may arise when unforeseen circumstances impact performance or when not all of the organization's performance is appropriately reflected in the plan. Developing guidelines is helpful so the committee has established principles for when and to what extent discretion will be applied.

Compensation Committee Annual Cycle



CEO Performance Assessment

The committee (often in collaboration with the board chair) typically will undertake an annual review of the CEO's performance to inform pay determinations and goal setting. The committee chair may lead the process of collecting feedback. Formal processes often include an annual questionnaire for all board members to provide feedback, along with discussions to assess the CEO's performance and development needs. The CEO will complete a self-assessment and report on performance. These items will be discussed in an executive session when the CEO's pay is determined and will also inform goal setting. (The Governance Institute provides customized CEO evaluation tools for its members.)

Annual Compensation Approvals and Reasonableness Determination

Annually, the committee will review and approve the CEO's recommendations for compensation actions for executives, as well as determine the CEO's compensation, including salary increases, incentives, and other arrangements.

To inform its deliberations, the committee will be provided with peer market data to assess the competitiveness of current compensation levels and the organization's program design. The competitive data should include both total compensation and each element of pay for each position reviewed (salaries, incentives, benefits), and should also provide details on the program's value and design. Before receiving the data, the committee should approve the peer group(s) to be used for the competitive evaluation. The committee should carefully consider the peers and total compensation data, as this will inform its determination of pay reasonableness.

The committee will review and approve the CEO's recommendations for compensation actions for executives and determine the appropriateness and reasonableness of compensation. The committee will then meet in executive session to determine the CEO's compensation. If the board has ultimate approval authority over the CEO's pay, the committee will present its recommendation to the board for approval.

Succession Planning and Leadership Development

Effective succession planning and leadership development processes are critical for health systems. While other board committees may oversee succession planning, the compensation committee most often plays an important role in the process because it has responsibility for rewards programs that are designed to recruit, retain, motivate, and reward senior talent, and because it has regular discussions and insight into the performance of the CEO and senior team.

The committee should receive an update at least annually on the organization's CEO and senior leadership succession plans and preparations to assess whether any risks need to be managed. The updates may include, for each position, a summary of an emergency successor, current readiness of potential internal successors, and plans for external recruiting. The committee may also be updated on talent development plans and processes. Using this information, the committee can assess potential risks and determine if compensation is appropriately competitive and if any retention interventions are needed.

Regulatory Trends and Developments Updates

The committee should receive an annual update on executive compensation, performance, talent, and governance/regulatory trends and developments, to ensure it stays aware of market changes.

Other Agenda Items

The committee's meeting agendas may also periodically include the following:

- **Philosophy and program changes:** The committee will periodically be asked to review and approve changes to the executive compensation philosophy and program (e.g., incentives, benefits).
- **Individual pay arrangements:** The committee may be asked to review and approve special pay arrangements for executives, including new hire agreements, retention awards, and special incentive programs.
- **Leadership structure and cost:** The committee may wish to understand if the executive structure and aggregate leadership costs are optimal. In addition to ensuring that individual pay is competitive and reasonable, the committee may also consider the total cost and structure of management to assess overall efficiency. Priorities include a review of leadership headcount, distribution of roles by level, management layers, titling guidelines, and spans of control. Leveling guidelines should be reviewed to support talent development and integration.
- **Committee self-assessment:** A periodic review of the committee's effectiveness in discharging its duties should be undertaken. The committee will typically complete a questionnaire on its scope, processes, and support to identify potential areas of change.
- **Contract and other agreements:** The committee will periodically need to review and approve employment contracts, severance agreements, retention agreements, and other arrangements for select executives.

Committee Working Process

The committee's process should be collaborative and include the following:

- The chair should meet with management and outside advisors before each meeting to prepare the agenda and to preview the materials that will be reviewed.
- For items warranting significant discussion, the committee chair will discuss items with each member prior to the meeting to get initial perspectives to facilitate an effective discussion.
- On an ad hoc basis, the chair should periodically meet with the CEO or other management representatives to discuss priority topics.
- After each meeting, the chair should report the committee's work to the board.

On an annual basis, the chair should report to the board on the executive compensation program, the committee's process, and key decisions:

- Overview of the committee composition, charter, and calendar.
- Summary of the executive compensation philosophy and program.
- The decisions made by the compensation committee regarding the approved levels of compensation, incentives and benefits, the resulting competitiveness (for the CEO position and other executives in aggregate), as well as reasonableness.
- Recommendations to the board for changes to the compensation committee structure or charter for future compensation cycles.

Ultimately, the compensation committee should perform its function independently, while also understanding that it serves a broader purpose: serving the board on behalf of the organization.

The committee should note the value in horizontal coordination with other board committees whose duties sometimes interact with its own, such as audit and compliance, quality and safety, nominating and governance, and human resources.

Compensation Committee Composition

Organizations should seek to compose the compensation committee's membership to meet various goals, including the breadth of knowledge of committee members and the efficient operation of committee meetings.

Two key issues are "table stakes" for any compensation committee member:

1. Qualifications mean the prospective committee member has prior experience in compensation, finance, human resources, or prior service on similar governing board committees (while recognizing that most committee members will not have prior experience in all areas).

2. There is a lack of conflicts of interest, including meeting any corporate policy requirements regarding conflicts of interest and ensuring “disinterested” status with respect to the compensation arrangements to be reviewed and approved by the committee. Disinterested status means that committee members:

- Should not economically benefit from the compensation arrangements being reviewed and not have any family member’s benefit.
- Should not be in an employment relationship subject to direction or control by an executive whose compensation is being reviewed.
- Should not receive compensation or other payments subject to approval by an executive whose compensation is being reviewed.
- Should not be in a position to have an executive whose compensation is being reviewed approve a transaction providing economic benefits to the committee member (for example, approval of an outside services contract).

Once those table stakes are met, an organization seeking to compose an ideal committee should consider that diversity of viewpoints is important. Ideally, at least one member will have a background and experience in each of the following areas of finance, compensation, human resources, and benefits, as well as general corporate board governance.

Is Your Compensation Committee Set Up for Success?

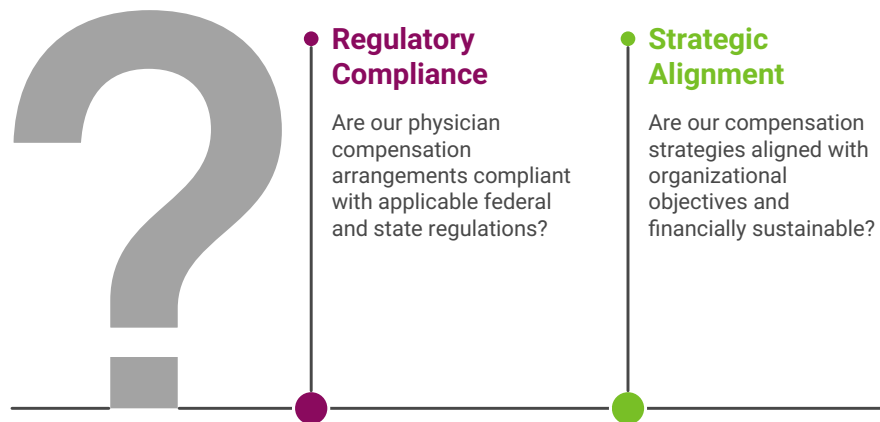
- ✓ Qualified members
 - ✓ Independent and conflict-free
 - ✓ No financial or reporting conflicts
 - ✓ No influence from executives under review
 - ✓ Diverse expertise across key areas
-

Physician Compensation Governance: Best Practices

Physician compensation governance is not simply an administrative exercise. It represents a critical intersection of regulatory compliance, financial stewardship, and organizational strategy. For health systems, the governance of physician compensation arrangements presents both a significant compliance obligation and a strategic opportunity to align physician behavior with enterprise objectives while managing cost and risk.

This section presents a comprehensive framework for physician compensation governance grounded in two predominant domains of modern governance: **regulatory compliance and compensation strategy**.

As organizations navigate evolving regulatory scrutiny, labor market pressures, and care delivery transformation, physician compensation decisions can no longer be made in isolation or without some effective and formalized oversight. Effective governance provides the structure required to ensure defensibility, financial stewardship, and strategic alignment. At its core, physician compensation governance must address two fundamental questions:



Organizations that cannot confidently answer both questions face elevated regulatory risk, competitive disadvantage, and potential financial instability.

The Dual Nature of Physician Compensation Governance

As noted, physician compensation governance operates at the intersection of **compliance** and **strategy**:

Regulatory compliance: Physician compensation arrangements must maintain compliance with applicable federal and state laws, including the Stark Law, the AKS, and corresponding state-level requirements. Importantly, compliance extends beyond abstract legal standards to encompass the specific facts, circumstances, and documentation supporting each arrangement.

Compensation strategy: Compensation strategy translates organizational goals into compensation structures that address real-world challenges, including:

- Designing financially sustainable compensation plans.
- Ensuring accurate plan administration.
- Recruiting and retaining physician talent.
- Aligning incentives with evolving care delivery models.
- Advancing enterprise strategic imperatives.

EFFECTIVE GOVERNANCE REQUIRES these two domains to function in tandem. Compliance without strategy produces defensible but potentially inefficient arrangements. Strategy without compliance exposes the organization to regulatory risk regardless of business rationale.

Governance serves as the structural foundation that integrates these domains. In the absence of formal governance, decision making becomes fragmented and inconsistent, documentation is often insufficient to withstand regulatory scrutiny, compensation inequities emerge across the medical group, and regulatory vulnerabilities may remain undetected until enforcement action occurs.

Regulatory Compliance Is the Governance Imperative

The primary purpose of regulatory compliance governance is to ensure that all physician arrangements—whether employed, independent contractor, or hybrid—satisfy applicable legal requirements. This framework must be applied consistently across the organization and supported by documentation sufficient to demonstrate compliance.

Notably, regulators increasingly focus on the *process* by which compensation decisions are made rather than solely on compensation outcomes. A disciplined, well-documented governance process can be as critical as the specific compensation levels themselves.

Key Areas of Compliance Focus

1. Fair Market Value (FMV)

FMV represents the cornerstone of physician compensation compliance. Organizations must demonstrate that compensation levels are commercially appropriate and defensible on the basis of objective criteria. Effective FMV governance requires:

- **Documented FMV methodologies** applied consistently across arrangements.
- Benchmarking against **reliable and relevant market data sources**.
- **Consideration of arrangement-specific factors**, including specialty, geography, productivity expectations, and scope of services.
- **Scheduled reassessments** to reflect evolving market conditions and changes in arrangement structure.

2. Commercial Reasonableness

Commercial reasonableness evaluates whether an arrangement makes sound business sense, independent of referrals or other business generated by the physician. Governance processes should assess:

- The organization's legitimate need for the services.
- Viable alternative approaches.
- Alignment with organizational strategy and care delivery objectives.

Together, FMV and commercial reasonableness form the backbone of defensible physician compensation arrangements.

Compensation Strategy and Strategic Governance

While regulatory compliance establishes boundaries, compensation strategy determines how organizations deploy physician resources to achieve mission-driven and competitive goals. Strategic governance provides the infrastructure that enables organizations to operate effectively within compliance constraints.

COMPENSATION STRATEGY EXTENDS far beyond selecting benchmark percentiles. It encompasses the policies, principles, and practices that shape how physicians are recruited, retained, compensated, and aligned with organizational objectives.

A clearly articulated compensation philosophy is a pillar of compensation strategy. A compensation philosophy provides a consistent framework for decision making and often includes elements such as:

- **Market positioning:** Target compensation relative to benchmarks (e.g., median, 75th percentile).
- **Compensation mix:** Balance among base salary, productivity incentives, and quality or value-based components.
- **Internal equity:** Approach to compensation variation across specialties, sites, and practice settings.
- **Alignment principles:** Reinforcement of organizational values, integration goals, and care models.

In the absence of a defined compensation philosophy, compensation decisions tend to be reactive and inconsistent. A well-defined philosophy supports transparency, defensibility, and long-term sustainability.

Governance Along a Risk-Tolerance Continuum

Physician compensation governance is not one-size-fits-all. Governance structures should be viewed along a continuum shaped by organizational maturity, complexity, and risk tolerance. Below, we illustrate the positions (Low, Mid, and High) on the risk tolerance continuum.

Risk-Tolerance Continuum			
Characteristic	Limited Board Oversight (Low)	Standard Board Oversight (Mid)	Enhanced Board Oversight (High)
Delegation	Broad delegation to management	Delegation with defined approval thresholds	Limited delegation with comprehensive, recurring board review
Involvement	Retrospective, high-level involvement	Periodic FMV and commercial reasonableness reviews	Structured review criteria applied consistently
Oversight Mechanisms	Limited, informal oversight mechanisms	Regular reporting to a board committee	Formalized, frequent, and detailed board reporting
Risk	Higher inherent compliance and reputational risk	Balanced efficiency and oversight	Highest level of governance rigor and defensibility

Market Practices and Observed Governance Structures

Trending across large health systems, both academic and regional, is a dual-committee structure that balances board-level oversight with operational efficiency.

Board-Level Oversight

Governance begins with the board of directors, typically acting through a dedicated board committee focused on physician arrangements. This board committee:

- Retains some defined level of accountability for physician compensation.
- Approves significant or out-of-parameter physician compensation arrangements.
- Receives regular reporting on compensation trends, costs, and compliance.
- Establishes policies and decision-making thresholds.
- Ensures alignment with organizational strategy.

Day-to-day decision-making authority is delegated to management operating within parameters set by the board or board committee.

Key responsibilities commonly include:

- Reviewing proposed compensation arrangements and variance requests.
- Monitoring compliance and identifying matters requiring board escalation.
- Overseeing independent FMV and commercial reasonableness opinions.
- Supporting board committee reporting and education.

Many organizations supplement management governance with a physician compensation advisory group. This group serves in an advisory capacity, providing physician input on compensation policy, plan design, and the clinical implications of compensation decisions.

An optimal physician compensation governance architecture aligns board oversight with the organization's risk tolerance while enabling informed decision making. By establishing clear delegation pathways, incorporating physician input through advisory structures, and calibrating oversight to organizational maturity, healthcare organizations can strengthen governance, reduce risk, and support long-term sustainability.

Disclosure and Transparency

Today's political and regulatory climate continues to put the spotlight on executive compensation practices across corporate America. This is particularly evident in healthcare and among not-for-profits. Healthcare costs and accessibility are expected to be highly contested issues in the upcoming elections. Added to this is a growing distrust among workers in the ability of government and corporations to address the ever-increasing cost of living and provide greater opportunities for lifestyle success. Measures to limit executive compensation in not-for-profit healthcare have been pursued by unions and government representatives in state-wide or local initiatives.

Additionally, physician compensation practices are increasingly being reviewed at the board level to ensure oversight of risk and compliance related to FMV and commercial reasonableness. Physician leaders and/or physicians with highly productive clinical practices may have pay levels similar to or exceeding those of executives. The board should be aware of the processes that management is taking to ensure regulatory compliance and manage risk as penalties for non-compliance are significant and severe.

Why Disclosure Matters Now

- ✓ Increased regulatory and political scrutiny
 - ✓ Growing community and workforce expectations
 - ✓ Rising complexity of compensation decisions
 - ✓ Expanded board accountability and visibility
-

Executive and physician compensation practices will continue to attract scrutiny and prompt organizations to be more transparent, given political discourse, high costs, market volatility, the rise of social media and community voice, and populist uprisings over perceived disparities between average worker and executive and physician pay.

The IRS and attorneys general monitor not-for-profit organizations to ensure reasonable executive compensation decisions, good governance, and comprehensive, accurate

disclosure. Charitable care is a front-and-center issue for state charity officials who continue to probe tax-exempt organizations' commitment to providing healthcare to those who cannot afford it. Healthcare organizations have a responsibility to federal and state regulators, their communities, and their employees to ensure the appropriate use of financial resources to maintain charitable purpose and not-for-profit status. Not-for-profit organizations must earn their tax-exempt status. Documenting community benefit is critical; this has become increasingly more difficult due to the complexities of today's health systems and antiquated reporting mechanisms (i.e., how information is reported on the Form 990).

Given regulatory, community, and media scrutiny, board members require an understanding of the steps that the compensation committee takes to fulfill the board's fiduciary responsibilities to ensure oversight and reasonable compensation.

While demonstrating a strong compliance-oriented governance process is critical, organizations must also balance this duty with the need to attract and retain a talented and capable leadership team. As health systems become more complex, talent may

be pursued not just from healthcare but also from general industry organizations where significantly higher compensation levels may be offered, given the ability to provide equity opportunities. Additionally, increased complexity, spans of control, consolidation, and the blurring of talent markets have led to increases in executive pay as health systems become some of the largest employers in the nation.

Performance is a critical factor when determining executive pay. Executive compensation should be determined in accordance with prevailing and reasonable market practices—with performance playing a key role in the compensation committee’s decision-making process. Higher compensation opportunities are aligned with higher performance outcomes to drive improvements in quality, safety, patient and employee satisfaction, access, and financial sustainability. Programs may also be designed to drive longer-term efficiency, growth, mission-related, and strategic objectives.

The board, through its compensation committee, most often bears responsibility for governing the executive compensation program and may also oversee physician compensation. The committee is responsible for communicating the program to the full board, and the level of communication should be sufficient to allow the board to exercise its oversight and fiduciary responsibilities, evaluate legal risks, and ensure that costs and practices do not conflict with the organization’s tax-exempt purpose.

Communicating Executive Compensation Information to the Full Board

Board members who do not serve (or have not served) on the compensation committee may not be privy to executive compensation information except as provided on the Form 990. They also may not understand the process the compensation committee uses to make executive and/or physician compensation decisions. Not only is this important from a compliance perspective, but a strong communication process can also provide board members with valuable insight into talent management and succession planning issues.

Given changes in workforce demographics and needs, talent shortages, the increasing use of AI, changing leadership competency needs, and industry challenges, the board should carefully consider its role in human capital planning—especially as it relates to the leadership team. Information from the compensation committee to the board can provide important insight into the leadership team’s strength and performance.

A review of the executive compensation program with the full board is especially important if the organization is experiencing recent media coverage of compensation data reported on the Form 990, significant physician relations issues, labor union activity, or other public or adverse events, or if it is expected that the executive compensation program will be publicly and negatively depicted.

The board approves the charter of the compensation committee and its authority for making executive compensation decisions. Board members should be given the opportunity to review the organization’s executive compensation philosophy and overall program design, as well as the compensation provided to the CEO and key leaders, particularly those individuals reported on the Form 990. This may include physician leaders and highly compensated clinicians.

However, there often exists a delicate balance in determining the types of compensation information that board members need to know and understand to fulfill their oversight responsibilities, and the types of information that should remain in the domain of the compensation committee due to concerns on conflicts of interest, executive privacy, the complexity of the committee's decision-making process, the regulatory framework around not-for-profit executive compensation, and the potential for disruption or distraction at the full board level.

THE COMPENSATION COMMITTEE is authorized by the full board through its charter to make executive compensation decisions, and its members are selected for their ability to do so. But the full board oversees the delegation of this function and bears the ultimate fiduciary duty.

A balanced yet comprehensive approach to disclosing the organization's executive (and potentially physician) compensation principles and practices should be provided to all board members. The intent of this disclosure is to help the full board understand the mechanics, facts, and circumstances of compensation decisions. The level of disclosure should carefully consider the organization's bylaws, governance structure and culture, conflicts of interest, legal requirements, and risk factors (i.e., regulatory and media attention).

Annual board education on the executive compensation governance can provide board members with the opportunity to better understand the process, ask questions, and be prepared for scrutiny. In addition to information on CEO pay, Form 990 disclosures, the compensation committee's annual decision-making process, regulatory compliance, market trends, and environmental updates could be provided. This may lead to healthy board discussions on other potential risk factors such as longer-term executive talent management and succession planning.

Some board members may be uncomfortable voicing questions and concerns in an open forum. Therefore, board members should be encouraged to know that, if additional questions or concerns arise, the board chair or compensation committee chair can provide additional context privately or in an executive session as appropriate. All conversations should be considered confidential due to executive privacy concerns.

The types of information that should be considered for disclosure to the full board include, but are not limited to, the following:

- The organization's compensation philosophy, including the overall intent of the program, pay and benefit components, and the desired market positioning
- A summary of the process used by the compensation committee to make executive compensation decisions, and how this aligns with board fiduciary and committee charter responsibilities
- A description of the market(s) used to assess reasonable compensation

- Factors and performance considered by the compensation committee in making executive compensation decisions
- A full description of the CEO's program, including key employment contract provisions, and how the program compares to comparable marketplace practices (so that there would be no surprises if the media runs a story on the CEO's pay or contract)
- A description of other senior executive and physician leader compensation programs (for physicians, a description of how FMV and commercial reasonableness are determined and managed)
- The relationship between executive compensation and organizational performance, and the performance metrics considered in making compensation decisions
- Any issues regarding organizational and/or individual executive performance that may affect board and/or public perception
- Descriptions of the measures taken by the board or committee to obtain reasonableness opinion letters or legal counsel advice

The types of disclosures should be determined based on a range of factors, including facts, circumstances, and legal considerations. State law or corporate bylaws may mandate certain types or levels of disclosure to the full board.

ULTIMATELY, DISCLOSURE OF executive compensation to the board is one of the most important responsibilities undertaken by the compensation committee.

Communicating Executive Compensation Information to Employees, Physicians, Labor Unions, and the Community

Political, media, and populist uprisings have highlighted the need for the board to understand and articulate how organizations ensure strong executive compensation governance practices. Employee, physician, labor union, and community perceptions are undoubtedly important to organizations that rely on the government and their communities for support and resources. Basic principles of fairness, market competitiveness, and regulatory compliance should be considered in communicating with these groups.

Full disclosure of executive compensation information to employees and communities is not mandated—except by way of the IRS Form 990—for not-for-profit healthcare organizations. However, organizations should determine whether selected and additional information should be made available. For example, labor unions often refer to Forms 990 during negotiations or organizing campaigns. Because these forms often contain limited or unexplained information, compensation amounts reported on these forms can be misinterpreted if not communicated effectively. Double reporting of executive deferred compensation or retirement elements can occur on Form 990, and the annualized value of compensation is often misconstrued.

Accurate, timely, and appropriate disclosure of selected information may help provide a better framework for constituents to better understand the foundation on which fair and reasonable executive compensation decisions are made. While certain situations (e.g., adverse publicity) may call for a tailored approach, **organizations should have the following information readily available in anticipation of any event that calls for communication of the executive compensation program:**

- Form 990 information for the organization, and for other organizations to which the organization compares itself for compensation purposes
- Summary of the organization's executive compensation philosophy and how this compares to the broad-based employee compensation philosophy
- Description of the process used by the board or compensation committee to make reasonable, performance-based executive compensation decisions (emphasizing independence and use of outside experts)
- Summary of the organizational goals and key executive performance expectations as well as major achievements over the past few years
- Description of the relationship between organizational performance and pay
- The value of the community benefit provided by the organization to support its tax-exempt status
- Considerations used in executive compensation decision making, such as cost of living, talent retention/recruitment considerations, performance, and how these align with the factors used in establishing pay for the rest of the workforce
- Measures taken to improve the broad-based employee workforce experience, well-being, and engagement

Addressing the Media

Certain events may trigger media inquiries, such as labor union, physician, and employee relations issues; patient care and quality/safety issues; financial difficulties and layoffs; executive and board member changes; organization changes (mergers, acquisitions, or divestitures); recent publicity concerning industry difficulties; and recent publicity concerning executive pay levels. Organizations should be well prepared to address any inquiries from the media concerning executive compensation. Last-minute preparations for interviews can often lead to disastrous results.

Most often, organizations respond to media requests via their public relations departments. Public relations executives are typically well-versed on the dos and don'ts of media relations and often have well-established relationships with the media. However, a public relations executive may find it difficult to respond directly to a reporter's questions regarding pay for top executives. Therefore, organizations should identify a board member, typically the board chair or the compensation committee chair, to serve as a spokesperson on executive compensation issues. This person should be well-trained in responding to media questions.

The CEO should refrain from responding to the media, even if the questions seem to relate only to pay packages for other executives, as the interview often prompts questions about the CEO's own compensation. This media relations role is best served by the board or compensation committee chair.

If appropriate, organizations should identify outside experts, such as public relations specialists, consultants, or legal counsel, who may get involved in responding to media inquiries. These outside experts can guide the board on handling media inquiries in potentially negative or disruptive situations.

As media requests are often specific to recent hot-button issues, it is important that the spokesperson and the public relations executive understand the story's ultimate intent and purpose. If a story prompts more detailed questions from the community or attracts national attention, an organization should prepare a more comprehensive statement concerning a commitment to transparency and executive compensation levels, programs, and processes.

In responding to inquiries by the media, the spokesperson should bear in mind the following guidelines:

- Be prepared to discuss how compensation levels compare reasonably in the marketplace.
- Confirm Form 990 information; correct mistakes in interpreting annualized compensation, including addressing the issue of Form 990 double-reported deferred compensation or retirement income; inform or remind reporters that this information is publicly available and the organization is committed to disclosure to the community.
- Emphasize the pay-for-performance aspects of the executive compensation program and the linkages to organizational performance.
- Summarize the compensation committee's process for making executive compensation decisions and highlight the independence of compensation committee members in the decision-making process.
- Prepare information on the community benefit provided by the organization as Form 990 may not tell the whole story.

The more prepared the organization is to respond to these situations, the greater the likelihood that any concerns can be addressed in a forthright, accurate, and timely manner.

Media Readiness Checklist

- ✓ Designate a trained spokesperson (board chair or committee chair)
 - ✓ Be ready to explain pay vs. performance
 - ✓ Understand Form 990 nuances (e.g., double reporting)
 - ✓ Prepare a clear community benefit narrative
-

Disclosing Compensation Information on Form 990 or by Other Means

Treasury Department regulations require tax-exempt organizations to allow public inspection of their annual tax returns. The Form 990 requires disclosure of total compensation for officers and key employees, including pay for hours worked, incentives/bonuses, contributions to employee benefits programs, deferred compensation, and expense accounts/other allowances. The rules for Form 990 reporting have become rigorous, to the point that the IRS, in some cases, requires reporting certain forms of compensation (such as non-qualified deferred compensation) over multiple years.

The Form 990 is somewhat akin to a for-profit company's annual proxy statement as a public disclosure document. In publicly traded companies, the SEC requires the inclusion of a compensation committee report in the proxy, which may include all or some of the following: the company's compensation philosophy, the basis for determining executive pay (particularly for the CEO), and the relationship between executive pay and performance. In response to calls for greater transparency, not-for-profit healthcare organizations should consider disclosing information similar to that required in the for-profit environment.

Failure to properly disclose information on tax forms may cause the IRS to treat pay or benefit items as automatic excess benefits, triggering intermediate sanctions and excise taxes for the recipient and for those board members who approved the economic benefit. Organizations should consult tax attorneys and/or their accountants on the proper disclosure of information on all required tax forms.

Not-for-profit organizations should consider disclosing more information publicly via Forms 990, annual reports, and/or websites. These additional venues provide a means to communicate more fully with constituents about the organization's mission, policies, programs, services, goals, outcomes, and accomplishments. These venues can also provide a means to communicate selected information regarding the organization's executive compensation principles, policies, and governance process.

Organizations that file public reporting documents may also want to take the opportunity to explain selected executive compensation programs and/or payouts by the use of footnotes and/or in documentation attached to Form 990. While footnotes on and attachments to the Form 990 are not required, they can be an effective way to provide greater explanation or context for large-ticket items and/or double-reported deferred compensation or retirement information.

Additional information can also be provided regarding the executive compensation philosophy and the compensation committee's process for making executive compensation decisions, demonstrating strong and independent governance. Information may also be provided in the organization's annual report and/or on the website, such as:

- A description of the compensation committee's process in making executive compensation decisions and an indication of the types of decisions made by the committee

- A listing of the board members who serve on the compensation committee and an indication of their ability to make independent, conflict-free decisions
- An indication of committee members' background and experience that qualifies them to make executive compensation decisions, and the number of meetings throughout the year required to fulfill responsibilities
- A summary of the organization's executive compensation philosophy
- The organization's intent to link executive pay with organizational and individual performance
- The organization's commitment to its tax-exempt purpose and the needs of the community, particularly reinvesting in the future of the communities' healthcare.

These communications support the organization's efforts for full and transparent disclosure to the public at large.

Strengthening Governance Approvals

In addition to the recommendations in the preceding chapters, not-for-profit leadership may wish to consider the following suggestions to strengthen governance approvals. Efforts to validate the reasonableness and diligence of the compensation approval process could be interpreted as evidence of a “good faith” exercise of the board’s fiduciary obligations:

- A. **Charter:** Under the supervision of the organization’s chief legal officer, the compensation committee should periodically review its charter for appropriateness/adequacy of detail and direction, as well as for consistency with the board’s overall approach to committee practice. Any suggested changes or refinements should be brought to the full board for approval (or other committee responsible for periodically reviewing committee charters and recommending changes or modifications to the full board for approval).
- B. **Committee structure:** Work with the board’s governance committee (or other committee responsible for oversight of the board’s committee practice) to monitor the value of a single committee being responsible for both executive and physician compensation, or whether physician compensation should be addressed in a subcommittee of the compensation committee, or in a completely separate committee.
- C. **Authority:** Periodically review with the governance committee (or other committee responsible for oversight of the board’s committee practice), the organization’s chief legal officer, and counsel to the committee, the nature of the committee’s authority (e.g., with delegated powers or simply advisory in nature), the implications of that authority, and whether change is recommended.
- D. **Composition:** Maintaining compensation committee membership at a level of competency that is commensurate with the committee’s obligations will, in many cases, be a constant challenge, especially if the committee is responsible for both executive and physician compensation. The compensation committee will need to work closely with the governance and nominating committee to ensure the appointment of committee members who possess clear expertise in compensation-related matters and who satisfy relevant independence and conflicts of interest policies and protocols. Other issues on which to coordinate with the governance and nominating committee will include the requisite level of commitment expected from compensation committee members, and whether the compensation committee should, in the interest of preserving its unique expertise, be excused from certain board refreshment policies.
- E. **Governance coordination:** The compensation committee, guided by the organization’s chief legal officer, should ensure a proper level of coordination with other board committees whose charter responsibilities may overlap with those of the compensation committee. These may include (but are not limited to) executive, audit and compliance, search and succession, and governance and nominating

committees. Special effort should be made to coordinate with the committee that reviews physician and other strategic transactions to ensure continuity in legal and tax diligence and risk assessments.

- F. **Executive coordination:** Subject to appropriate conflicts of interest protocols, compensation committee leadership should ensure a proper degree of coordination and information sharing between its own dedicated outside counsel and the chief legal officer. In addition, the committee should be assured that its meetings are staffed and supported not only by inside and outside counsel, but also by members of the management team who have information relevant to committee deliberations (again, subject to conflicts protocols). This could include, for example, executives supporting compliance, audit, finance, and human capital.
- G. **Reliance:** Regardless of the nature of the committee's authority, the compensation committee should regularly consult with the organization's chief legal officer on the ability of the committee and the full board to rely on the advice of its outside advisors and experts.

Appendix: Sample Documents

Sample Executive Compensation Committee Charter

*Please note that this is a sample of an **executive** compensation committee charter. If physician compensation were to be included under this committee's purview, the charter would be expanded to include the committee's oversight role and responsibilities.*

This Charter of the Executive Committee (when acting as the Executive Compensation Committee) was adopted by the Board of Directors (the "Board") of ABC Health (hereafter "ABC") on [Month Day], [Year].

This Charter is a component of a flexible framework within which the Board, assisted by its committees, directs the affairs of ABC. While the Charter should be interpreted in the context of all applicable laws and regulations, as well as in the context of ABC's Governance Policy and Bylaws, it is not intended to establish by its own force any legally binding obligations.

I. PURPOSE

The Executive Compensation Committee (hereafter the "Committee") is authorized to act on the Board's behalf in (i) determining appropriate compensation for ABC's executives and other disqualified persons; (ii) evaluating executives' and other disqualified persons' compensation plans, policies, and programs; (iii) reviewing benefit plans for executives and other disqualified persons; and (iv) verifying that compensation information is appropriately and fully disclosed.

Definition of a disqualified person is any person who was in a position to exercise substantial influence over the affairs of the applicable tax-exempt organization. It is not necessary that the person actually exercise substantial influence, only that the person be in a position to do so.

For purposes of this Charter, "executives" are defined as ABC executives and all other disqualified persons as validated by the Committee.

In discharging its role, the Committee is empowered to investigate any matter brought to its attention with access to all books, records, facilities, and personnel of ABC. It has the authority to retain outside counsel, compensation consultants, or other experts and will receive adequate funding from ABC to engage such advisors. It shall have the sole authority to retain, compensate, terminate, and oversee the advisors, who shall be accountable directly to the Committee.

To support the Committee, an annual calendar will be developed containing the necessary agenda items the Committee will need to carry out its duties. The Committee will also receive training in compensation plan design and administration, including legal and regulatory issues as needed.

II. COMMITTEE MEMBERSHIP

The Board Chair, in consultation with the Governance Committee, will appoint a Chair of the Executive Compensation Committee; additionally, the Board Chair, in consultation with the Governance Committee, may appoint other Committee members, as appropriate.

Each member of the Committee shall be independent, which is defined as a non-employee member of the full Board not receiving any consulting, advisory, or other compensatory fee from ABC. Committee members must also be “disinterested” (i.e., have no conflict of interest) with respect to executive compensation matters subject to Committee review and approval. At the start of each year, each member will review the Board’s and Committee’s Conflict of Interest Policy to ensure he or she has no conflict of interest and is “disinterested.” At the start of each Committee meeting and before debating and voting on any compensation arrangement, each member shall reaffirm his or her “disinterested” status (whether he or she has a conflict of interest regarding the compensation arrangement), and such declarations will be recorded in the meeting minutes.

If any matter comes before the Committee for review and approval, and a member of the Committee is not disinterested with respect to that specific matter or for the specific executive involved, the interested Committee member shall declare his or her interest to the other members of the Committee before deliberations and voting with respect to that matter, and shall be excused from the portion of the meeting as to which he or she has the disqualifying interest. Any questions regarding the disinterested status of a Committee member shall be referred to the Chair and legal counsel.

The Committee Chair will convene all sessions, set meeting agendas, and determine the Committee’s information needs.

III. COMMITTEE SUPPORT STAFF

The Committee shall be assisted in fulfilling its duties and responsibilities by ABC support staff:

1. The President and Chief Executive Officer (CEO)
2. Chief Human Resources Officer (CHRO)
3. Chief Legal Counsel (CLO)

From time to time, the Committee may request that other executives serve as support staff or present information to the Committee.

IV. COMMITTEE MEETINGS

The Committee shall meet no less than three times per year (or more frequently as circumstances dictate) and according to the Committee calendar. A majority of the members shall constitute a quorum sufficient for the taking of any action by the Committee.

Each meeting will conclude with an executive session.

V. KEY RESPONSIBILITIES

The following responsibilities are set forth as a guide with the understanding that the Committee may diverge from this list as appropriate, given the circumstances. The Committee shall report any divergence from this list to the full Board. The Committee is authorized to carry out these and such other responsibilities assigned by the Board from time to time, and take any actions reasonably related to the mandate of this Charter.

To fulfill its purpose, the Committee shall:

1. Establish, annually review, and modify as needed ABC's executive compensation philosophy.
2. Review, validate, and approve the goals and objectives relevant to the compensation of the ABC executives, including annual performance objectives.
3. Coordinate the evaluation of the CEO's performance with input and advice from the full Board.
4. Review a summary of the performance evaluations of other executives and disqualified persons. These evaluations will be prepared by the CEO (or designees) for the Committee.
5. Develop and approve changes, in advance of their implementation, to the CEO's compensation.
6. Review and approve changes, in advance of their implementation, to the compensation of all executives and disqualified persons. Recommendations will be prepared by the CEO (or designees) for the Committee and include executive base salaries, incentive compensation plans and awards, and executive standard and supplemental benefits and perquisites.
7. Administer the executive total executive compensation program in a manner that is consistent with the executive compensation philosophy and strategy, and that qualifies for the rebuttable presumption of reasonableness under the intermediate sanctions regulations.
8. Maintain minutes or other records of Committee meetings and activities, as required by intermediate sanctions regulations and governance best practices.
9. Verify that executive compensation information is appropriately disclosed to the full Board and on the organization's Form 990 as required by regulation or governance best practices.
10. Review excise tax liabilities as determined under Code Section 4960 of IRS regulations.
11. Report regularly to the full Board on Committee findings and approved actions and any other matters the Committee deems appropriate or the Board requests.

12. Engage independent, outside advisors (e.g., attorneys, compensation consultants, etc.) to provide objective and impartial compensation data and express an opinion on the reasonableness of total compensation as defined under Code Section 4958 of IRS regulations.
13. Communicate with external parties, as determined appropriate, and in accordance with ABC's media inquiry protocols, regarding Committee procedures and the compensation of the organization's executives and disqualified persons.
14. Review periodically the components of ABC's executive total compensation program to determine whether they are properly coordinated and achieve their intended purpose(s), and approve appropriate modifications, including new programs.
15. Provide appropriate oversight of executive succession planning and leadership development.
16. Review and reassess the adequacy of this Charter annually and amend it as the Committee and Board deem appropriate.
17. Conduct an annual self-evaluation of the Committee's performance, including its effectiveness and compliance with this Charter.

Sample Executive Total Compensation Philosophy

*Please note that this is a sample of an **executive** total compensation philosophy statement. If physician compensation were to be included under the committee's purview, the philosophy would be expanded, or a separate physician compensation philosophy statement would be developed.*

The Executive Compensation Committee is responsible for reviewing and approving total compensation for executives under its purview. This includes any that may be deemed to be a "disqualified person" within the meaning of the intermediate sanctions rules of federal tax law.

The executive total compensation philosophy serves as the foundation for current and future ABC executive compensation and benefits decisions. This philosophy is developed to provide guidance and direction for overall executive compensation decision making across all ABC entities (including subsidiary organizations), recognizing that unique business situations and judgment factors can affect these decisions.

GUIDING PRINCIPLES

ABC recognizes that its ability to fulfill its mission and vision depends on the caliber of its workforce and senior leaders. To that end, ABC strives to design its executive compensation program to:

- Attract and retain the most highly qualified executives whose leadership is essential to carrying out the organization's mission and strategic goals
- Provide ABC executives with a reasonable and competitive total compensation opportunity consistent with the organization's charitable purpose obligations and tax-exempt status, supported by independent decision-making and market-based compensation practices intended to qualify for the rebuttable presumption of reasonableness under the federal tax law intermediate sanctions rules, and compliant with all appropriate federal and state regulations

EXECUTIVE COMPENSATION PROGRAM COMPONENTS

Total cash compensation, which is comprised of base salaries plus incentive awards, is the primary component of ABC's executive total compensation program. ABC's total cash compensation program is intended to reinforce and reward significant performance achievements:

- **Base salary**, which is established according to competitive and appropriate market practices and is intended to reflect the executive's capabilities, experience, tenure, and performance in a position

- **Incentive compensation**, which is intended to encourage and reward the executive team for achieving or surpassing specific Committee-approved performance objectives
- **Special compensation payments** (i.e., sign-on bonus, retention incentives, etc.) may be used to attract/retain selected executives if their employment is critical to ABC’s strategic success

Benefits, which are comprised of market competitive standard benefits—such as health, dental, vision, life insurance, disability, retirement, and paid time off—are provided to all ABC employees. In addition, ABC executives may also receive market-competitive supplemental benefits, as required and determined based on a business, market, and personal needs basis.

Employment contracts or individual separation/severance pay arrangements may be necessary to attract and retain key individuals and provide security in the event of organizational “change of control” or other transitions that may result in job loss.

PEER GROUPS

The competitive marketplace for executives includes the industries and organizations with which ABC competes for talent and from which it is most likely to recruit. For executive compensation purposes, ABC’s primary comparator group is defined as not-for-profit healthcare organizations across the United States similar in size, structure, and complexity.

Other relevant comparator markets may be referenced, such as medical groups, health plans, and general industry, if and when competitive circumstances warrant these markets, and when additional data are necessary to represent the retention/recruitment market for the executive.

Data will be compiled in a manner consistent with the IRS intermediate sanctions rules of federal tax law, to reflect what is “ordinarily paid to like executives by like enterprises under like circumstances.”

MARKET POSITIONING

It is ABC's intention to position total compensation, *in the aggregate, between the XXth and XXth percentiles of the market*. Total compensation may be set above the XXth percentile in select cases of exceptional performance, but only upon approval by the Committee.

Conversely, total compensation may be positioned below the XXth percentile when performance metrics are not achieved (i.e., no incentive compensation is earned/paid).

Governance Dashboard for the Executive Compensation Committee <i>(excluding physician compensation responsibilities)</i>	FY26
Review and revise, as necessary, the executive compensation philosophy .	☑
Review and recommend changes to the board, as necessary, related to the committee's charter .	☑
Review market data provided by an independent compensation consultant with respect to similarly situated organizations to assess the relative position for each component of executive compensation.	☑
Review and approve the incentive compensation plans , including performance objectives, award opportunities, and eligible participants. Receive regular progress reports on performance.	☑
Review and approve all executive compensation and benefit plans and arrangements .	☑
Assure that executive total compensation is reasonable under all relevant facts and circumstances.	☑
Review and approve the CEO's recommendations for executive compensation for disqualified persons .	☑
In coordination with the board chair, facilitate the CEO's annual performance review .	☑
Review, establish, and approve the CEO's compensation .	☑
Provide appropriate communication and disclosure to the board of the committee's work and activities.	☑
Periodically review employment agreements and severance agreements/policies .	☑
Provide for appropriate oversight of tax-qualified and non-qualified retirement plans .	☑
Provide appropriate oversight of executive succession planning and leadership development .	☑

Sample Compensation Committee Advisor Evaluation Form

(Confidential—For Internal Governance Use Only)

1. The advisor is independent, impartial, and free from conflicts of interest.

Rating: Strongly Agree Agree Neutral Disagree Strongly Disagree

Comments:

2. The advisor has strong expertise in not-for-profit health system executive compensation and relevant regulatory requirements.

Rating: Strongly Agree Agree Neutral Disagree Strongly Disagree

Comments:

3. Advice provided is objective, reliable, and clearly presented to support compensation decisions and sound governance/oversight.

Rating: Strongly Agree Agree Neutral Disagree Strongly Disagree

Comments:

4. The advisor understands the organization's mission, strategy, and organizational context when providing advice.

Rating: Strongly Agree Agree Neutral Disagree Strongly Disagree

Comments:

5. The advisor maintains confidentiality and adheres to high ethical standards in all interactions with the committee and management.

Rating: Strongly Agree Agree Neutral Disagree Strongly Disagree

Comments:

6. The advisor keeps the committee informed of emerging compensation trends, regulatory updates, and best practices in not-for-profit health systems.

Rating: Strongly Agree Agree Neutral Disagree Strongly Disagree

Comments:

7. The advisor is accessible, responsive, and timely, and provides support that enhances committee effectiveness.

Rating: Strongly Agree Agree Neutral Disagree Strongly Disagree

Comments:

8. Overall, the advisor adds value to the committee’s effective decision making.

Rating: Strongly Agree Agree Neutral Disagree Strongly Disagree

Comments:

Additional Evaluation Items

Areas for Improvement:

Additional Comments or Suggestions:
