Donald C. Wegmiller, FACHE

# Accountability and CEO Behavior

*Moving beyond Sarbanes-Oxley.*

In the four years since the American Competitiveness and Corporate Accountability Act of 2002, or the Sarbanes-Oxley Act (SOX), was passed to regulate corporate oversight of for-profit entities, many nonprofit organizations—including hospitals and health systems—have adopted SOX policies as best practices even though they are not bound legally to comply with most of its regulations.

The area of financial reliability and transparency is being addressed thoroughly and well by CEOs of nonprofit healthcare organizations, as shown by several studies. But there is another area of responsibility that has evolved from the SOX legislation, which for-profit organizations are addressing and which nonprofit CEOs should as well: board accountability.

Regulating bodies are increasingly interested in nonprofit healthcare organizations. Questions for nonprofits surrounding board accountability are being raised by a number of entities that heavily influence the way nonprofits conduct business. Some bond-rating agencies now include a section on governance in evaluating debt ratings. They are formally asking pointed questions related to governance and evaluating the answers as part of the debt-rating process.

In addition, government agencies have begun weighing in on nonprofit governance practices. The Internal Revenue Service (IRS) is asking questions of tax-exempt organizations through its Compliance Check Questionnaire concerning several areas of operations including community care programs, compensation practices and board organization. The U.S. Senate Committee on Finance and the U.S. House Ways and Means Committee are exploring whether nonprofits are fulfilling their community benefit responsibilities. These inquiries are centered on governance, not elements of the SOX legislation. Essentially they want to know whether governing boards are in tune with what their hospitals are doing in the community.

On the state level, state attorneys general are aggressively scrutinizing nonprofit governing board practices. A community benefit requirement is on the books in 15 states and will be the mechanism by which other state attorneys general, legislatures or governors will begin to enforce board accountability in the other 35 states.

Finally, insurers, led by the Chubb Group, are putting forth questions regarding governance practices in their process to determine premiums for director and officer liability insurance.

**What CEOs Need to Know**

This scrutiny is putting pressure on CEOs to change their behavior. Even though the initiatives from these entities are directed at their governing boards, CEOs must ask themselves what they are doing to assist their boards in dealing with these major governance issues.

To help frame board accountability issues that have arisen in the wake of SOX, following are some points that for-profit CEOs and boards are actively addressing:

1. **Even more questions will be posed around conflicts of interest.** Regulators will be on the lookout for potentially self-serving interests of board members and simply will not allow them. For example, an insurance agent in the hospital's community who provides the hospital's insurance will not be allowed to serve on its audit committee and probably not on its executive compensation committee.

2. **Boards that do not practice formal board member succession planning will face increased scrutiny.** Just as the National Association of Corporate Directors is asking for-profit CEOs and boards such questions as whether their board has term limits or age limits, The Joint Commission has developed a section on governance in its accreditation

process. And not only are these entities asking the questions, but they are providing the preferred answers. For example, boards should have term and age limits.

3. **Board membership selection practices will be questioned.** As a best practice, incompetence on the board should not be tolerated; as a compliance issue, a state attorney general may find cause to disassemble your board, as was the case in Minnesota at Allina Health in 2001.

4. **Executive compensation is an IRS hot button.** However, boards—not the CEO—will be the target of the IRS if excessive compensation is being distributed. On the other hand, if the board has an appropriate executive compensation deliberation process, it will go a long way toward shielding itself from undue scrutiny.

**How CEOs Should Respond**

In the arena of board accountability, the CEO's job is to be proactive and protect the board. There are a number of actions CEOs can take to help support their board as the best possible stewards of a nonprofit healthcare organization.

Guide your board to create a formal succession plan for both the board and the executive suite. For example, Texas Health Resources in Dallas–Fort Worth plans its next board chair as well as the one after that.

Next, protect your board from IRS fines related to excessive executive compensation by helping create a process leading to a "rebuttable presumption of reasonableness"—basically, a safe harbor. The CEO should help the board seek out an external consultant who can assist the board in developing an executive compensation philosophy. The consultant can then intelligently guide the board and help put an appropriate process in place. The board will need to decide the answers to questions such as: Who is the peer group to which it should compare itself; where should it position itself against that peer group; and what is its philosophy with regard to incentive compensation?

If all these practices are followed and the decisions of the board are well documented, the IRS must accept the outcome as reasonable unless it can prove otherwise. This also protects the board from community and media criticism and embarrassment as well as undue regulatory scrutiny.

Finally, CEOs need to be attentive to certain processes—audit, financial oversight, executive compensation—and should coach, guide and secure outside resources to aid their board in defining and approving these processes. In this way CEOs are proactive in protecting their board, ensuring best practices in the field and promoting goodwill throughout the organization and within the community. ▲

*Donald C. Wegmiller, FACHE, is chairman of Integrated Healthcare Strategies, formerly Clark Consulting, Minneapolis. He can be reached at don.wegmiller@clarkconsulting.com.*