



## INTEGRATED HEALTHCARE STRATEGIES™

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# Conducting Effective Compensation Committee Meetings

## Part 1 of 3: Protection from Intermediate Sanctions

Presented by Integrated Healthcare Strategies  
as Authored by Dan Schleeter

As you consider your executive compensation committee, are you frustrated by any of the following?

- Postponed pay decisions because the committee can't seem to get its work done in its meetings
- Repeated raising of issues that seem to question the foundation of pay policy
- Discussions of executive pay that have little or nothing to do with health care, or your organization
- Generation of solutions by committee members, rather than them asking management or the consultant for recommendations and then accepting or rejecting those solutions
- Worry that the executive compensation committee may not be taking the fundamental actions they should be taking to protect the executives and board members from intermediate sanctions

If you have been concerned with any of the above situations, then a number of questions have likely surfaced:

*What strategies can make the executive compensation committee meetings more effective?*

*Are there any strategies or techniques that could be implemented to help the executive compensation committee complete its agenda within the time allotted?*

*Are there any simple steps the committee could take to better protect executives and themselves?*

*How can the committee chair handle disruptive members?*

*What is the CEO or board chair to do when the committee starts coming up with its own pay programs, rather than working through management or consultants?*

We often hear concerns such as these expressed by our clients. In an effort to address these important questions, the Executive Total Compensation practice of Integrated Healthcare Strategies is presenting a three part series on the topic, starting with this issue, and continuing over the next two future issues as noted below:

*Part I: Protection From Intermediate Sanctions – begins below*

*Part II: Diagnosing and Solving Committee Inability to Complete its Agenda – August newsletter*

*Part III: Reining in the Committee That Want to Do It Their Way – September newsletter*

## **Part I: Protection From Intermediate Sanctions**

### *Synopsis*

- Fundamentals of protection from intermediate sanctions
- Two simple actions to take in executive compensation committee meetings to promote protection from intermediate sanctions

### **Fundamentals of Protection from Intermediate Sanctions**

The 1996 Taxpayer Bill of Rights (TBOR 2) authorized the IRS to apply intermediate sanctions to any excess benefit transaction within a tax-exempt entity. Intermediate sanctions under the TBOR 2 include taxes and penalties on individuals receiving excess benefits, as well as taxes and penalties on anyone who knowingly approved any excess benefit transaction.

An excess benefit transaction arises when a tax-exempt 501(c)(3) or (4) organization provides an economic benefit to persons such as executives that exceed the “fair market value” of the consideration the tax-exempt organization receives in return. A comprehensive consideration of TBOR 2, fair market value, excess benefit transactions, and like subjects is beyond the scope of this article, but there are a few simple steps an executive compensation committee chair can take to provide significant, needed protection.

It is important to understand that the establishment of a “rebuttable presumption of reasonableness” is the easiest and most cost-effective way for an organization to protect itself

from IRS claims that it has provided executives an excess benefit transaction. If properly established, the rebuttable presumption of reasonableness shifts the burden of proof to the IRS.

The establishment of the rebuttable presumption has been very effective in protecting organizations, executives, directors, and trustees from intermediate sanctions.

The process of the establishment of a rebuttable presumption of reasonableness is a subject for more in-depth discussion than this article will provide, but it can be boiled down to meeting three criteria as outlined in the table below.

| <b>Three Criteria For Establishing the Rebuttable Presumption of Reasonableness</b> |  |
|---|--|
| I.  | Executive compensation transactions must be approved in advance by an independent authorized body (the board or the executive compensation committee) made up entirely of independent members with no conflict of interest regarding the compensation of the executive |
| II.   | The authorized body must obtain and rely on appropriate comparability data for like positions in like organizations and in like circumstances  |
| III.  | The authorized body must adequately document in their minutes the diligence with which they govern executive pay, their intent in doing so, and also ensure certain significant facts are included, such as terms of decisions, and comparability data relied upon     |

### **Compensation Committee Meeting Process and Minutes**

Our suggestions in this article focus on two simple actions the executive compensation committee can take during the meeting, and then record in their minutes, to help promote the establishment of the rebuttable presumption. These suggestion are to address:

- Committee member independence and lack of conflict of interest in making decisions about executive pay
- The committee's intent to follow the process necessary to establish the rebuttable presumption of reasonableness

Our work with clients suggests that these steps are sometimes missed in meetings and missing from minutes.

### **Conflict of Interest**

As noted in the third criteria in the establishment of the rebuttable presumption of reasonableness, what is said in minutes will be critical.

The IRS gives its field auditors a “Rebuttable Presumption Checklist” of what to look for in determining whether exempt organizations have met the requirements for a rebuttable presumption of reasonableness. One of the items reads as follows:

14. Names of and actions (if any) by members of authorized body having conflict of interest: \_\_\_\_\_

Clearly, the auditor is looking to address a key part of the first criteria for the establishment of a rebuttable presumption of reasonableness -- member conflict of interest.

#### Intent to Follow Process for Establishing the Rebuttable Presumption

Committee members should know the process to follow to establish the rebuttable presumption of reasonableness, but unless their understanding of the process is recorded, and they state their intent to follow that process and meet the three criteria, there is no documentation that they know. If so, the establishment of the rebuttable presumption could be jeopardized. Also, members may need reminding from time to time what the process is.

#### **Script for Compensation Committee Meetings**

Since minutes should note conflicts of interest and how they were resolved, and should demonstrate committee intent to establish the rebuttable presumption, it is easy to simply ensure that these two items actually come up during the meeting by giving the executive compensation committee chair a simple script such as the following to read at the start of every meeting.

#### OPENING SCRIPT FOR ALL MEETINGS

“It is the intention of this meeting to establish a rebuttable presumption of reasonableness for all executives who are considered disqualified individuals. Do all members present understand and agree with this statement?”

“One of the key requirements for establishing a rebuttable presumption of reasonableness is that committee members must affirm independence with regard to making decisions about the executive compensation matters on the meeting agenda. Do any members have a conflict of interest with regard to the compensation of the executives under consideration here?”

The script ensures that in case a member does not know the process for establishing a rebuttable presumption of reasonableness, they are told, and also ensures that the committee's intent to establish the rebuttable presumption will be noted. The script also brings up the independence and conflict of interest question, and enables the committee to address it if needed, or more likely, note full independence from any conflict of interest.

Beyond reading this simple script, minutes recording what was said need to be prepared, of course. The resulting minutes notation might read as follows:

#### SAMPLE LANGUAGE FOR MINUTES

“Committee members reaffirmed their intent to establish a rebuttable presumption of reasonableness for .... “ (the pay matter and executives under consideration at the meeting)

“None of the Committee members reported a conflict of interest with regard to the compensation of ... “ (the executives under consideration at the meeting)

### Summary

This article details just one example of the diligence that should be encouraged at the meeting to ensure that the documentation in the minutes provides the kind of information an IRS auditor would look for. It reviewed the fundamentals of protection from intermediate sanctions, as well as two simple actions to take in executive compensation committee meetings to promote protection from intermediate sanctions.

Following is a brief synopsis of the subsequent two parts in this three-part series on Conducting Effective Compensation Committee Meetings that will be featured in our next two newsletters:

### **Part II: Diagnosing and Solving Committee Inability to Complete its Agenda**

#### *Synopsis:*

- Diagnosing why the committee can't get its agenda completed
- Broad strategies for improving the likelihood of achieving meeting agendas
- Techniques to use in the meeting to address legitimate concerns without compromising the regular meeting agenda

- Ways to manage disruptions, including disruptive members, and still get things done

### **Part III: Reining in the Committee That Want to Do It Their Way**

#### *Synopsis:*

- Typical examples of compensation committees going their own way, and the consequences
- How and why the above situation arises
- Redefining roles: governance, not management
- Redefining expectations: thoughtful advice to refine pay plans, not taking action
- Utilizing member strengths in discerning, questioning, thinking, and addressing constituent interests

#### ***About Integrated Healthcare Strategies***

*Integrated Healthcare Strategies is a leading human capital firm offering a complete array of consulting services through its five practice groups that exclusively serve the health care industry. Our Executive Total Compensation practice is focused on the analysis and design of compensation and benefits programs provided to executives, physicians, and other key employees. Our client base encompasses the full spectrum of health care organizations. Integrated Healthcare Strategies takes pride in its creativity and track record in developing innovative solutions to compensation and benefit issues. Our other services include physician strategy and compensation, human capital solutions, labor relations, leadership transition planning, executive search, employee surveys, performance management and trustee governance solutions. For more information, call 1.800.327.9335 or visit [www.IHStrategies.com](http://www.IHStrategies.com).*

#### ***About the Authors***

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