

VIEWPOINT

Turning Up the Heat On Institutional Integrity

BY EDWARD A. KAZEMEK AND BARRY S. BADER

TAX-EXEMPT ORGANIZATIONS AND NOT-FOR-PROFIT hospitals and health systems, in particular, are under fire as never before, and their boards are on the front lines. Congressional leaders, tax-seeking state and local governments, the IRS, state attorneys general, labor unions, plaintiffs' attorneys, bond rating agencies, and the news media are scrutinizing, criticizing and attempting to reform how boards perform their oversight responsibilities.

The pressures are compelling boards to rethink how they conduct business. Painful as that process may be to hard-working and generous trustees, it can be healthy, strengthening the bonds between not-for-profits and their stakeholders.

Unsettling Facts

Not-for-profits constitute a growing share of the economy and attract billions of dollars in donations. Contributions to health care providers rose 16 percent in 2005 to \$7 billion, according to the Association for Healthcare Philanthropy. The public has a right to expect boards of tax-exempt organizations to be competent and above reproach; yet, closer scrutiny finds that board rigor is often absent.

We have just completed an investigation into not-for-profit, hospital and health system governance. Based on our research and collective experience with health care boards, we have documented our conclusions in the white paper, "Emerging Standards for Institutional Integrity: A Tipping Point for Charitable Organizations."* This paper shows that:

*Readers who would like more information about the white paper are encouraged to contact either of the authors.

- The vast majority of boards tolerate conflicts of interest as long as they are disclosed. Few have "disabling guidelines" to determine when a conflict is so material that an individual should not be a board member.

- Many boards, following the spirit of Sarbanes-Oxley, require that only "independent" directors handle executive compensation and audit oversight functions. Yet, few boards have precise, measurable criteria to determine who is independent and who isn't.

- Many trustees are not privy to the details of executive compensation decisions, even though the IRS expects the full board—not just a committee—to review and approve execu-

utive pay. When the news media know more about the CEO's salary and benefits than the trustees, there's a problem.

- Until recently, most boards did not calculate or publicize the charitable benefits provided by the hospital to their communities, nor did they ensure that community benefits equaled or exceeded the value of their tax exemptions.

- Most boards do not require a transparency strategy to communicate information on mission effectiveness and stewardship to their organization's stakeholders.

- Many boards treat self-evaluation as a routine exercise, not as a priority to ensure governance effectiveness.

Passing Fads?

The growth of the charitable sector, unethical conduct by a few bad business people, and the breadth of external scrutiny all portend that the challenges to health care organizations' tax-exempt status and board performance are not passing fads. New laws, tougher regulations and demands for greater disclosure are likely.

Until now, not-for-profits enjoyed the public's presumption of doing good with unselfish motives. Now, institutional integrity must be demonstrated. Many boards have unwittingly left themselves exposed with a "business as usual" approach. Volunteerism and good intentions are no excuse for lower governance standards. Continued inattention to nationally recommended practices for board independence and oversight is irresponsible and undermines all the good that our hospitals and health systems do.

Become Proactive

Governing boards need to get their houses in order and ensure that their practices meet the highest standards of accountability, transparency and ethical conduct. We recommend that boards assess their particular risks, but, at a minimum, complete these six practices:

1. Conduct a rigorous review of conflict-of-interest policies and procedures, including:

- Adopting "disabling guidelines" that spell out when a trustee's conflicts are so great that he/she should not serve on the board

- Creating a measurable definition for an "independent" director

- Ensuring that conflicts are reviewed by a

committee of independent trustees

- Making the entire conflict-of-interest process transparent for all board members

2. Revisit the adequacy and transparency of executive compensation oversight. Aspire to practices that meet IRS "rebuttable presumption of reasonableness" standards.

3. Use emerging industry standards to define, measure and set goals for community benefit to ensure that community benefit activities exceed the value of the organization's tax exemption. Make sure the organization is telling its story to the community.

4. Ensure that the full board understands the Form 990 information that is filed with the IRS and that it meets the highest standards for completeness and accuracy.

5. Assess the organization's public transparency strategy for communicating its quality, safety, prices and governance policies to the public.

6. Compare the board's structures, composition, policies and procedures with recommended best practices and adopt enhancements. Treat board evaluation, including individual director evaluation, as a priority that is designed to improve board performance continuously.

Reject the Status Quo

Some board members and CEOs will argue that more vigorous accountability and transparency practices will be costly and divert resources from the organization's charitable mission. We believe, however, that accountability and transparency are part of the mission. Mere compliance with the law is no longer good enough. Boards must ensure that their policies and practices are beyond reproach.

Efficient, effective governance is worth the price. Strengthening board independence and oversight will maintain the public trust and protect an institution's most priceless asset—its reputation. **T**

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