GREAT BOARDS

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Rising Expectations Require Not-for-Profit Boards to Demonstrate Their "Institutional Integrity"

by Barry S. Bader

When the Internal Revenue Service released a dramatically expanded version of the Form 990 tax return in December 2007, it marked the culmination of a year of increasing criticism and rising expectations for not-for-profit organizations generally, and hospitals and health systems specifically.

Federal agencies, congressional leaders, state attorneys general, labor unions, and local revenue authorities all stepped up their attacks on tax-exempt hospitals. Meanwhile, a variety of organizations and associations, including the IRS, the American Hospital Association, Independent Sector, and The Governance Institute all published guidelines recommending practices that would enable not-for-profits to demonstrate their community benefit, corporate integrity, prudent financial stewardship, and ethical conduct (see sidebar describing Form 990 on the next page and the timeline of events on page 15).

As the external demands on not-for-profits escalate, the reaction from many boards and executives has followed the familiar five stages of grief – and organizational change: denial, bargaining, anger, depression, and finally, acceptance.

DENIAL. Many hospital leaders believe that the only organizations at risk are those whose executives and boards are guilty of serious ethical misconduct or dereliction of their community-benefit responsibilities. The leaders of Provena Covenant Medical Center in Illinois would argue otherwise: Provena lost its local tax exemption despite a commendable community benefit record.

BARGAINING. Some hospital leaders believe that if government agencies would only set clear and consistent standards for reporting on community benefit, executive compensation, clinical quality, and so forth, not-for-profit hospitals will make the required disclosures and their compliance will be apparent. In reality, disclosure is likely to be just one step toward more stringent regulation. The IRS already uses its "compliance checks" to target organizations to audit, and several legislators have proposed minimum standards for charity care to qualify for tax-exempt status.

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ANGER. Many healthcare leaders are outraged that the same political leaders who approve costly, unfunded mandates and low Medicare and Medicaid reimbursements would criticize an industry that provides millions of dollars in charity care and other community benefits to the most vulnerable members of the community. Similarly, many trustees are distraught because the same standards for governance independence that the Sarbanes-Oxley Act requires for investor-owned corporations are being applied to not-for-profits, where similar abuses haven't occurred. Some are concerned about the loss of valuable directors due to stiffer standards for conflict of interest. However, the fact is that Sarbanes-Oxley has become a de facto benchmark for assessing the practices of all types of boards.

DEPRESSION.
Depression may be too strong a word to describe the reaction to the pressures facing tax-exempt hospitals – healthcare has too many "Type A" personalities in executive suites and boardrooms to admit depression. Nonetheless, it's a lot easier to generate enthusiasm

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Institutional Integrity 2007-2008: A Timeline of Rising Expectations

February 2007— AHA's Blue-Ribbon Panel recommends that boards promote transparent performance reporting and oversee programs to meet stakeholders' needs.

March— Head of the Smithsonian Institution resigns following press reports and Congressional allegations of irregularities in executive compensation, travel expenses, ethical conduct, and board oversight.
— IRS compliance checks of executive compensation document "significant reporting errors and omissions" and result in $21 million in excise taxes.
— Illinois Department of Revenue revokes tax-exempt status of two more hospitals.
— California state agency conditions approval of $910 million in tax-exempt bonds on Sutter Health's contribution of $8.5 million to support community health clinics and electronic health information systems for rural hospitals.

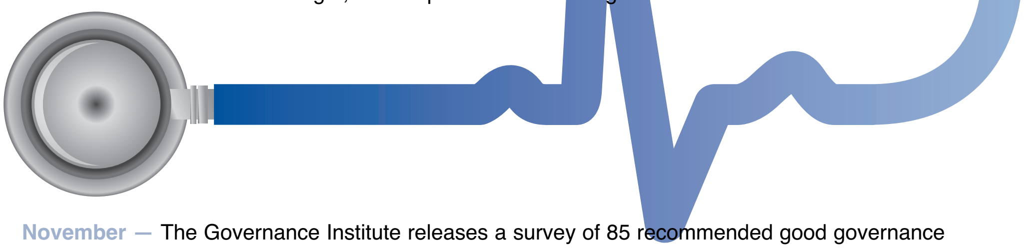
April — Report finds that 32 state legislatures now require hospitals to report pricing information, and six more have voluntary price reporting systems.

July — Senator Charles Grassley proposes two tiers of tax-exempt hospitals and minimum of five percent of annual revenues to be spent on charity care.
— IRS Commissioner Miller says the line between tax-exempt and commercial sectors is blurring.

August — HFMA releases latest recommendations to develop more rational, patient-friendly pricing systems.

September — Centers for Medicare and Medicaid Services announce results of patient experience surveys to be published quarterly beginning in March 2008 and added to clinical quality indicators on its Hospital Compare Web site.

October — Independent Sector Panel report recommends 33 principles for good governance and ethical practice covering legal compliance and public disclosure, effective governance, strong financial oversight, and responsible fundraising.



November — The Governance Institute releases a survey of 85 recommended good governance practices and finds a mixed record in meeting new institutional integrity requirements.

December — IRS releases the new Form 990.
— IRS announces its focus for 2008 will include executive compensation, community benefit requirements for tax-exempt hospitals, and Form 990 compliance.

January 2008 — Ohio's attorney general announces plan to impose community benefit requirements on not-for-profit hospitals by the end of the year.
— The American Hospital Association files amicus brief urging restoration of Illinois hospital's local tax exemption.
— Moody's Investor Service says bond ratings are affected by documentation that a "hospital's quality effort is translating into tangible results in improved financial performance."

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about strategic initiatives to expand clinical services and improve quality than to get leaders excited about investing time and money to meet complex government reporting requirements, such as the vastly expanded Form 990.

ACCEPTANCE. Finally, there are organizations that accept rising expectations for institutional integrity as an opportunity to strengthen governance practices, reconnect with their communities, and reassure their stakeholders that their not-for-profit hospital has not forgotten what makes it different: its mission and community commitment.

Getting Out in Front

A number of hospitals and health systems have reached the "acceptance" stage and are taking a proactive approach to one or more aspects of institutional integrity. Some hospitals have been motivated by a strong sense of mission; others are motivated by external pressures such as existing or anticipated state law. For example, in Vermont, a law called "Act 53 Hospital Report Card" requires hospitals to report on their quality of care measures, patient safety initiatives, quality improvement initiatives, community needs assessment, financial reports, governance, and complaint filing procedures.

Web sites provide a useful way to examine hospitals' and health systems' efforts to demonstrate institutional integrity. Although a Web site alone can't take a full measure of a hospital's initiatives, Web sites demonstrate transparency. They give journalists, legislative staff, and local residents an easy way to learn about the organization's good works and governance practices. For example:

COMMUNITY BENEFIT. As Elaine Zablocki's article in this issue points out, more and more hospitals are communicating their community benefit activities and financial assistance policies. Lucile Packard Children's Hospital at Stanford in Palo, Alto, Calif., publishes a community benefit report on its Web site, including descriptions of programs to improve access to care, address childhood obesity, and improve child safety. Advocate Health in Chicago describes on its Web site $296 million in community benefits it provided in 2006 and relates personal stories about the individuals it helped. St. Vincent Health System in Erie, Pa., has an easy-to-read community benefit report on its Web site, with six pages quantifying and explaining the system's charity care, health professions education and research, community health services and education, Medicaid shortfall, and contributions to community organizations, all totaling more than $12 million a year. The report also describes an economic benefit for the region of more than $625 million.

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What's Required by the New Form 990

The new Form 990 includes a section on "governance, management, and disclosure" that inquires about such items as:

- The number of voting directors and how many are "independent" (discussed later).
- Whether directors and key employees have any family or business relationships.
- Whether the full board received the Form 990 before it was filed and the process the organization uses to review the 990.
- Whether the organization has a conflict of interest policy, whether annual disclosures are filed, and how the organization regularly and consistently monitors and enforces compliance with the policy.
- Whether the organization has a written whistle-blower policy and document retention policy.
- Whether the process for determining executive compensation includes a review and approval by "independent persons," comparability data, and contemporaneous substantiation of the deliberation and decision.
- Whether the organization participated in a joint venture or similar arrangement and, if so, whether the organization has adopted a written policy or procedure requiring an evaluation of compliance with applicable laws.

The IRS also announced new schedules for reporting by hospitals and for tax-exempt bond activities. Hospitals must report the specific amounts expended for charity care, community benefit, and other community building activities; information on the organization's bad debt expenses, Medicare revenues, and collection practices; and the names of management companies, facilities, and joint ventures.

Hospitals must also provide information on their charity care policy, including the formula, based on Federal Poverty Guidelines, for determining whether patients are eligible for receiving free and discounted care, respectively.

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FINANCIAL STEWARDSHIP. Spectrum Health in Grand Rapids, Mich., publishes extensive financial information on its Web site, including its community benefit expenses, audited financial statements, and its budget for the forthcoming year.

QUALITY TRANSPARENCY. Alegent Health, which serves Nebraska and southwestern Iowa, reports its performance for the 21 Medicare-required quality indicators for treatment of heart attack, heart failure, and pneumonia, as well as for nine indicators that are part of the nationwide Surgical Care Improvement Project. The site also includes patient satisfaction scores for the system's six hospitals. Other systems and hospitals prominently displaying and explaining their clinical quality or patient satisfaction results include Sharp Healthcare in San Diego; Baystate Health in Springfield, Mass.; Southwestern Vermont Health Care; and Baylor Health Care System in Texas.

GOVERNANCE EFFECTIVENESS. Baptist Health South Florida in Miami has published its board policies on all the hot buttons of external scrutiny, including its policies governing loans to officers, directors, and trustees (it bans them); board member travel and reimbursement; executive air travel; meals and business entertainment expenses; conflict of interest; charity care; and community benefit reporting.

Alegent Health also has published its conflict of interest statement and disclosure form. Although the Web site does not disclose any conflicts that directors have reported, it does display the members of the board with their photographs, the charters for each board committee, and answers to such questions as: What does Alegent Health need to do to maintain its tax-exempt status? Does Alegent Health meet its obligations to provide charitable care in exchange for its tax exempt status? What is the difference between internal and external audit? How is the external auditor chosen? How are members of the finance and audit committee chosen?

PRICING TRANSPARENCY AND BILLING PRACTICES. Spectrum Health has been described as "passionate about building a better pricing system." It posts average prices for common inpatient and outpatient services on its Web site, along with a complete explanation of what's included and the typical charges paid by insurance companies. Geisinger Health System in Danville, Pa., has developed what it calls ProvenCare practices in cardiac surgery that enable it to quote a fixed price in advance and to guarantee that it will treat complications that occur up to 90 days after the procedure without additional charges.

Healthcare Partners Medical Group, a 400-physician practice based in Torrance, Calif., publishes its fee schedule for basic medical services on its Web site. Alegent Health has a tool on its Web site to enable members of various health plans to get a good-faith estimate of the costs of various procedures prior to admission. University Medical Center in Tucson has guaranteed that patients without insurance will be charged no more than what Medicare pays for a given service.

What Boards Can Do

Not-for-profit organizations once enjoyed a presumption they were doing good works for unselfish motives. Today they must demonstrate that they deserve their tax exemption and the public's trust. Four steps are critical:

1. Conduct an institutional integrity self-assessment. Assess the board's current readiness to address rising expectations for institutional integrity. The Governance Institute has published an "institutional integrity self-assessment instrument" that examines 72 recommended practices in six areas: financial integrity and transparency, corporate compliance, executive compensation, conflict of interest/director independence, public transparency, and community benefit practices. The self-assessment enables senior management and the board to make an objective and comprehensive examination of the organization's institutional integrity readiness, identify areas of risk and opportunities for improvement, and develop an action plan to address the highest priorities.

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2. Review the board's conflict of interest policy, disclosure requirements, and most importantly, how the policy is actually being enforced. Neither the IRS nor anyone else has banned individuals with a conflict of interest from serving on the board of a not-for-profit organization; however, the new environment demands that boards take a more stringent look at traditional practices. Boards should clearly define a conflict of interest to include any actual or potential economic transaction or other relationship that a director or officer (or business associates or members of their immediate family) has with the organization. All conflicts of interest should be disclosed annually, and immediately when they occur. Directors with a conflict of interest should not participate in discussion or voting on matters in which they have an interest, and the board should document in the minutes that such directors were not present during the board's deliberations.

The most common shortcomings in current board practices include:

— Vague definitions of conflict of interest that leave it up to individual trustees to determine if an economic relationship with the hospital could jeopardize their objectivity.

— The failure to define a relationship with a direct competitor as a conflict of interest that must be disclosed, and potentially as a reason to disqualify someone from serving on or remaining on the board.

— The failure to define who is an "independent director" (i.e., a director with no or minimal economic or other relationships with the organization) and to require that only independent directors may serve on the board committees that oversee executive compensation, audit, and corporate compliance.

— The failure to set a minimum percentage of the board that must be composed of independent directors.

— The failure to establish "disabling guidelines" which define conflicts so material that an individual should not be permitted to serve on or remain on the board when they occur. Examples are directors who are the spouse of a member of senior management, who hold a senior position with a direct competitor, or who have willfully violated the organization's policies on conflict of interest or confidentiality.

— The failure to have all conflicts of interest routinely reviewed by a committee composed of independent directors who determine whether the conflict is acceptable and if any special action (e.g., periodic competitive bidding) is required.

— The failure to make a summary report of all conflict of interest disclosures and the decisions of the independent review committee to all board members, so there is full transparency and no hidden agendas.

3. Review the requirements for the new Form 990. The new form asks whether the board has reviewed the form before it was submitted. Answering this question "no" is like saying, "please conduct an audit of our organization." The form also asks for a description of how the Form 990 was compiled. The IRS appears to be looking to see whether the organization has made a serious attempt to collect accurate information. The entire board, and particularly its audit and corporate compliance committee, should carefully review all the items required on the new form (see "What's Required by the New Form 990" on page 14), and should ask management to describe its processes for preparing the information to ensure they are thorough and reliable.

4. Educate the board and decide how to take a proactive approach to institute good governance practices and increased transparency with key stakeholders. Just discussing institutional integrity is not enough. With healthcare reform looming as a major issue in Congress and state legislatures, ensuring that the public and policymakers understand the tremendous work hospitals do for their communities and the ethical conduct of the vast majority of hospital boards and executives has never been more imperative. The public trust has to be earned every day if hospitals and health systems, along with their physician partners, are going to be heard as legitimate voices for patient care.

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