Building Better Boards in the New Era of Accountability

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SUMMARY • Healthcare boards are entering a new era of heightened accountability, scrutiny, and reform. Sarbanes-Oxley legislation, Internal Revenue Service scrutiny, pressure from creditors and bond insurers, activist state attorneys general, media attention, and other forces have sharply increased awareness of the importance of governance and have also raised the bar on what is required of boards and what is considered best-practice governance performance. Yet good governance cannot be legislated. The structure, composition, and specific required functions of boards can be legislated or mandated, but the effective function of boards cannot.

At the same time that governance faces this new era of accountability, it is also being bombarded with the legions of monumental challenges in the tumultuous healthcare field. Chief executive officers and their boards must be willing to recognize the challenges and risks to the field of governance in general and to their boards in particular. Furthermore, they must be willing to implement new strategies and approaches for successful governance, including becoming compliant with Sarbanes-Oxley requirements; conducting a comprehensive audit of the structure, function, composition, and culture of the board; and seeking board members from outside the community, among many others.

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GOVERNANCE HAS RAPIDLY emerged from relative obscurity to hot-topic status. Both the business and the antics of boards are routinely front-page news, the literature devoted to governance is exploding, universities have professors and concentrations of study in governance, and the field is brimming with newly minted governance consultants.

Meanwhile the pressures on healthcare boards and their members, their accountability, and their performance are both proliferating and intensifying. Further, the pressures on and the importance of the chief executive officer's (CEO) relationship with the board have never been greater.

The field of governance in general, and that of healthcare governance in particular, is at a tipping point. The question is, which way will it tip? More importantly, how can you as CEO help tip your board in the right direction?

The answers to these and other governance-related questions are of critical importance to you as the CEO of a hospital, health system, or other healthcare organization. As CEO, it is you who must work with, care for, lead, follow, collaborate with, cajole, restrain, embolden, educate, and, of course, report to the board—or, to put it more accurately, *your* board.

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Your board is many things, but perhaps most intangibly and most challenging to you, your board is a multifaceted paradox. It is your boss, but it usually follows your lead. It is, of course, unique, but it shares the characteristics and issues of many other healthcare boards. Your board is a singularity, a sole legal entity, but it comprises different individuals with often very different viewpoints. You have one boss—the board—but rarely does it speak to you with one voice.

For some of you, your board is a challenging strategic partner, a leader. For others, it is a comfortable follower, a sleeping bear that can awaken at any moment, mauling you and your career. For many of you, it is both.

Your board is indeed a paradox, but you may take some comfort from the fact that it is your paradox. You can do something about it.

GOVERNANCE AT THE CROSSROADS

We are entering a new era of board accountability, scrutiny, and reform that imposes significant new burdens and challenges on boards, board members, and CEOs. The high-profile, governance-related failures of the Allegheny Health Education and Research Foundation, Enron, WorldCom, and other organizations have heightened public consciousness about the importance of governance and have also raised the bar on what is required, acceptable, and considered best-practice governance performance.

Sarbanes-Oxley Act

The Public Company Accounting Reform and Investor Protection Act of 2002 (Public Law 107-240), better known as the Sarbanes-Oxley Act, and other regulatory changes now require much greater accountability for the boards of for-profit, publicly traded companies. While these standards do not yet fully apply to the boards of not-for-profit healthcare organizations, they are steadily and inexorably migrating into our world.

IRS Scrutiny

For example, the Internal Revenue Service (IRS) is increasing its scrutiny of boards of

not-for-profit, tax-exempt organizations through review of excess benefit transactions and is tending more often to hold board members personally and financially responsible for them. The IRS is also aggressively heightening its scrutiny of board oversight of compensation of the CEO. Furthermore, it has begun to express interest in board composition in terms of board member independence and freedom from conflicts of interest.

Creditworthiness

Meanwhile, the institutions that both issue and insure bonds to tax-exempt healthcare organizations are increasingly recognizing the relationship between creditworthiness and effective governance. They are beginning to require evidence of effective governance in the form of compliance with Sarbanes-Oxley and other governance reform requirements prior to issuing or insuring debt or as a condition of forbearance agreements for organizations in default of their bond covenants.

Effective Healthcare Board Governance

In 2003, the Office of Inspector General released a self-assessment guide focused on healthcare organization boards. The guide was designed to motivate boards to ensure that their organizations have effective corporate compliance programs that meet Medicare requirements.

Not to be outdone, several states are actively considering applying Sarbanes-Oxley-like requirements to not-for-profit boards within their borders. For example, California Senate Bill 1262, introduced in May 2004, would hold not-for-profit, tax-exempt organizations to many Sarbanes-Oxley-like standards relating to the composition of boards and certain board committees. In New York, the state attorney general introduced legislation to modify the Not-for-Profit Corporation Act to incorporate a number of Sarbanes-Oxley-like provisions.

In addition, many providers of directors' and officers' liability insurance are considering requiring evidence of effective governance structures and practices and board education as a condition of insurance and to minimize their exposure to loss.

Media Coverage

Finally, with print and electronic media reporters circling the waters sniffing for blood, many healthcare boards worry that they may easily find themselves targets of local, or national, media broadsides. For some, these worries have already materialized.

Handling the Pressure

Understandably, this new era of governance accountability is provoking unease throughout the world of healthcare. The increasing difficulty of healthcare governance, the growing time demands, the frequent political and social pressures on board members, the external scrutiny and accountability, and the possibility of embarrassment and even enhanced liability exposure are all frequently mentioned by board members who increasingly wonder aloud why they are on the board and whether they should remain.

In the face of all of this, it is important to remember that it is impossible to legislate good governance. Governance structure and the specific required functions of boards can all be legislated, regulated, or mandated; the *effective function* of boards, however, cannot. Whether and how a

board leads and its willingness to address challenging, controversial issues that carry high degrees of political and organizational risk cannot be mandated by external requirements. This must come from within each board, and from you, the CEO.

Unfortunately, in paradoxical response to these pressures, many CEOs are leading their boards in a full-scale retreat from effective governance. For example, one thoughtful long-time CEO of a successful regional healthcare system recently stated that he does not want an "educated board" because "then they will ask me too many questions." Another hospital CEO expressed his view that "it is not worth sending my board to education programs. They are a cost center anyway; why should I add to the cost?"

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Other CEOs have steadfastly refused to deal with blatant and excessive conflicts of interest on their boards or to update the way their boards oversee CEO performance evaluation and compensation, the external audit function, or board composition.

Meanwhile, other CEOs feel threatened by assertive board members who insist that the board honestly assess and upgrade its structure and function. Some of these board members have direct experience with Sarbanes-Oxley reforms and their impact on governance from serving as executives or board members of publicly traded companies, and they are unwilling to tolerate dysfunctional governance on other boards on which they serve. Many of these board members are greeted with disdain and resistance by their fellow healthcare board members and the CEO, who claim, as I have frequently heard, that "healthcare governance is different," or, "those requirements do not apply to us, and they never will."

These CEOs and boards are firmly placing their heads in the sand as they emphatically deny that Sarbanes-Oxley-like reforms are coming to not-for-profit healthcare governance, or that the behavior of their boards will be subject to greater scrutiny, or that increased transparency in all aspects of governance will be the new norm. Much more importantly, however, they deny the critical importance of truly effective governance in successfully leading healthcare organizations through the incredibly challenging times directly ahead.

The Big Risks to Governance in the New Environment

As healthcare governance faces these growing legal, regulatory, credit, and public pressures, it is also being bombarded with the legions of monumental challenges in the tumultuous healthcare field. The list that follows presents but a few of those challenges:

- Declining reimbursement
- Growth in the number of uninsured
- Fraying relationships between hospitals and physicians
- The impending collapse of Medicare
- The push for quality and patient safety
- The cost and challenges of information technology transformation

Because of the unfortunate confluence of these pressures, healthcare boards face an unprecedented set of challenges that threatens the continued viability of the governance model.

CEOs must recognize and respond to these general risks, as well as to specific warning signs of ineffective governance displayed by their own board, to ensure that their organizations will be agile, foresightful, and resolute enough to survive and thrive in the turbulent times ahead. Looking through a crystal ball darkly, here I present four of the most significant worst-case-scenario threats to healthcare governance.

1. The Failure of the Community-based Model of Governance

Since Benjamin Franklin created the first hospital board in the United States, a deeply ingrained belief has existed that governance on behalf of a particular community necessitates governance exclusively by members of that community.

The model whereby a hospital serving a specific community must be governed by members who live and work in that community has functioned well for hundreds of years. However, this model worked in, and largely because of, inefficient healthcare markets, which afforded boards the luxury of slow-motion leadership or no leadership at all. As healthcare markets become relentlessly more efficient and unforgiving, this model is under tremendous pressure. What used to be its very strength is now emerging as its critical weakness: the link of the board member to the community.

Specifically, as boards attempt to develop and implement strategies that are in the best interests of the organization and the community, they often discover that the community finds these strategies incomprehensible and abhorrent. For example, when tensions between a hospital and its physicians erupt into conflict, the community most often sides with the physicians against the hospital. How does a community express its disaffection with, and exercise leverage over, the board? By placing social, political, and economic pressure on the board members who live and work in the community, as well as their family members.

Board members who have attempted to prosecute necessary but challenging strategies that the community did not understand or appreciate have found themselves and their families ostracized, have seen their businesses boycotted and their financial fortunes suffer, and, in several cases, have even received death threats.

Increasingly, boards are hamstrung in their ability to effectively lead their organizations precisely because the board members are part of the community and they fear community resistance, outcry, and backlash. Fear of social and economic pressure from the community increasingly inhibits many boards from doing what they know is right but what they also know will generate a level of pain that they are not willing to tolerate.

2. The Failure of the Volunteer Model of Governance

Is the model of the volunteer, noncompensated, community-based board appropriate and viable in today's environment? Starkly framed another way, can the most complex type of organization in the United States—the hospital or health system—really be governed most effectively by amateurs?

As governance activities become ever more complex and challenging, consume increasing amounts of a trustee's time, and expose board members to enhanced scrutiny and liability, the de facto answer to that question in the future, however framed, may well be no.

FEATURE

True leaders will use imagination, creativity, decisiveness, and courage to govern.

The notion of abandoning the tradition of volunteer, noncompensated board members of healthcare organizations in favor of compensating them for their skills and service raises many strong and negative feelings. The putative advantage of the enhanced integrity, ethics, and purity of purpose of the volunteer trustee is typically offered as an argument against compensated boards.

Whatever the arguments, we must be prepared to consider any approach, however challenging to our sensibilities, that consistently creates effective, focused governance that actually leads to the long-term success of the healthcare organization. In today's challenging, complex, and litigious healthcare environment, the effective uncompensated board may be a thing of the past, and compensation may emerge as a component of effective governance.

3. The Inability to Attract and Retain Board Members

I have heard a small but growing number of reports from healthcare CEOs about board members who are resigning from office, or potential board members who are declining invitations to join the board. The reasons given include the significant time demands that appear unreasonable when compared with service on boards of other not-for-profit organizations, the social and economic pressures referred to in number 1 above, fear of embarrassment, fear of exposure to liability or regulatory scrutiny, and the mind-numbing complexity involved in governing a healthcare organization.

We may experience a living example of the old Groucho Marx joke, "I would never belong to a club that would have me as a member." Soon it may be the case that it is the most desirable, most savvy candidate for board membership who is the most unwilling to join the board because he or she is also the most savvy about the risks and demands.

All it may take to make this risk a widespread reality is a healthcare scandal, lawsuit, or regulatory sanction that results in high-profile board censure, liability, or public embarrassment. Or it may be a directors' and officers' insurance cost or availability crisis. Or it may simply be the growing burdens of hard work, intractable issues, increasing responsibilities, and impossible choices falling on healthcare boards like a steady rain that causes significant attrition among the nation's board members. We may experience a shortage of willing and able board members at a time when we need them the most.

4. The Prospect that Boards May Become Compliant Custodians Instead of Leaders

Good governance cannot be legislated. But, as we in healthcare know all too well, pettifogging and censorious compliance activities that consume time and energy and inappropriately alter focus certainly can be legislated. The risk is that boards will become so consumed by compliance with regulations, standards, legislation, and mandates that they will be unable, or forget, to govern. This, plus fear of directors' and officers' liability, may motivate boards to become cautious, detail-oriented plodders that lack the vision and willingness to take the risks necessary to provide the real leadership that is so much needed in these challenging times.

In this scenario, you as CEO run the risk of reversing your role with the board: turning board members into managers instead of leaders and forcing yourself to

become a leader in addition to, or instead of, a manager. Some fear that this is already happening. Richard Chait (2004), a professor at the Harvard Graduate School of Education and a long-time observer of not-for-profit governance, recently wrote that

> our current models of leadership—and governance—have elevated managers to leaders. Boards, as a result, often end up doing work that might reasonably be considered management. They look at budgets, they look at facilities plans, they develop market plans to improve their image or to attract clientele. Boards have become legitimators, auditors, and custodians of tangible assets. But not leaders.

Alarmingly, Professor Chait was referring to the normal state of not-for-profit governance, *absent* the governance compliance and accountability concerns raised here.

Strategies for Successful Governance

Governance is at a tipping point, and you as CEO can largely determine the direction in which your board tips. Not only must we work to avoid the worst-case scenarios outlined above but we must also strive to move our boards to become, and remain, true leaders. Such leaders will use imagination, creativity, decisiveness, and courage to govern. To do so will require you to push your board, and yourself, beyond the borders of your comfort zones. Here is a plan of action.

Become Sarbanes-Oxley Compliant Now

Do not wait, do not deny; do it now. You can use the Sarbanes-Oxley Act and all of the regulatory, legislative, and other bogeymen out there as the burning platform to motivate your board to change. Once it begins, this change can transcend the requirements and begin to move your board into best-practices territory.

The new corporate governance rules require that a majority of board members be independent, that is, that they not do business with the organization or are not otherwise conflicted. Further, the rules require that certain board committees—the audit committee, the compensation/CEO evaluation committee, and the governance/nominating committee—be composed *exclusively* of outside, independent board members. The audit committee should also have the authority to hire and fire the outside audit firm and should meet in executive session with the lead audit partner at least once a year.

These committees perform such critical governance functions that they should be composed entirely of outside, independent board members who have no conflicts, which could influence or corrupt these important board functions. Further, by ensuring that conflicted, or insider, board members constitute a clear minority of the board, a board composed of a majority of independent members can better maintain effective and ethical board function and stay ahead of the accountability curve.

Conduct a Governance Audit

You and your board must rigorously examine the entire scope of governance activities to make certain that they are not only up to snuff but that they are also on the road to governance best practices. To do this you must conduct a comprehensive governance audit.

A governance audit is a detailed and integrated review of the board's structure,

process, and function, with a focus on those governance areas that represent the greatest exposure to liability or sanction or risks of performance failure. An effective audit combines an honest and meaningful board self-evaluation (as opposed to the mindless pap that most boards currently engage in solely to satisfy the Joint Commission on Accreditation of Healthcare Organizations) and a brutally honest, external review of your governance structure, function, and process by an informed, objective outside consultant or legal counsel.

If you honestly look for the type of board members you need, you will find them.

An effective governance audit will most likely tell you and your board things that you do not want to hear. If both parties are willing to listen, you can begin the process of positive transformation toward best governance practices that will help you and your board effectively and truly lead.

Start Looking Outside Your Traditional Markets for Board Members

Putting people on your board who do not live and work in your community has two distinct advantages. First, these board members can bring a refreshing level of objectivity and honesty to the boardroom. They can be the "emperor has no clothes" board members and say what other trustees cannot because they are immune from social, economic, and political pressure by the local community. Second, you can recruit individuals with needed skills and experience that may not be available in your community.

In an era of challenged relationships between hospitals and physicians, having physicians on the board is often cited as a way to help address these tensions. In fact, however, this often exacerbates them by polarizing and paralyzing the board. Members of the medical staff who serve on the board would be considered insiders (nonindependent board members) by the IRS and under Sarbanes-Oxley and similar rules and therefore would be prohibited from serving on key board committees (audit, CEO compensation, governance/nominations). To gain the needed physician perspective on the board and to have physician board members meaningfully participate in important governance functions, you should similarly seek to recruit physicians from outside your community to serve on your board. Retired physicians who are truly independent minded and removed from medical staff politics and physician practice pressures may also fit the bill.

I have heard all of the protestations in response to these suggestions. Why would someone from outside the community want to serve on the board? Wouldn't we have to pay someone to do that? How could they govern when they don't know us? We will be giving up community control! For a very few isolated, rural organizations, the first two may be valid concerns. For everyone else, they are all simply practiced excuses. If you honestly look for the type of board members you need, you will find them. More importantly, these board members will help you elevate the quality of your governance. Just start with one or two outside board members, so there is no chance of giving up "community control."

Embrace Executive Sessions

If you are like most CEOs, nothing upsets you more than the notion of your board meeting without you—and talking about

you. News flash: your board, or at least many of its members, routinely talk among themselves without you being present. And they often talk about you.

The problems with these "corridor conversations" are many. They rarely involve the full board, and they contribute to the creation of factions and cliques. They magnify the voices of naysayers and axe grinders by allowing them to try out and refine their complaints until they find receptive ears. Further, you rarely get wind of these conversations when they are problems that can be nipped in the bud. Instead, issues often build to a boiling point until they erupt and surprise you, usually unpleasantly.

A solution, as well as a technique to generate better governance where your board takes more ownership for itself, is regular board executive sessions. Yes, this means you are not present at these meetings.

Your board is composed of adults. If you treat them as such and show your trust in them by encouraging them to meet in executive sessions, they will reward you by acting like adults and adjudicating their own problems, instead of making you pay for them. If, however, you lead with your insecurity, signal your belief that your board members cannot be trusted, and attempt to tightly control them, then they will meet your expectations. The sleeping bear will awake, and it will be hungry.

More than just a safety valve for good relations with your board, executive sessions allow the board to police itself and to identify problems in the early stages when they—and you—can most effectively address them. They also allow your board members to share uncertainty, to express the understandable fears and concerns they have in this environment, and, in doing so, to become what a board is supposed to be: a cohesive leadership team.

Make Board Meetings More Lively

Boards only exist when they are meeting, so the single most precious commodity a board has is its time together. It is during the board meeting when governance is supposed to occur. Yet most board meetings are rushed, heavily scripted affairs in which the board members spend most of their time listening to reports and focusing on the small issues.

Build in open discussion time on key, forward-looking strategic issues at every board meeting by getting rid of the unnecessary agenda materials that clog your board agenda book and waste the board's time. Although you can also do this at annual board retreats, this should not be the only time such discussion occurs. It must occur at every board meeting.

You as CEO should not feel like you must do all of the talking at board meetings. Every time a board member speaks, you or one of your staff do not have to be the first to respond. Good board meetings allow board members to talk to one another, to have dialog, to answer each other's questions, to build consensus. At your next board meeting, have one of your staff record who talks and who responds. Does the discussion flow go from board member to board member to CEO to board member? Or does it go from CEO to board member to CEO to board member to CEO? If you or one of your staff is doing most of the talking, it is time to listen more and talk less.

More engaging board meetings mean more engaged board members. The more engaged they become, the more they will understand and own the issues and the

more purpose and courage they will display in developing, implementing, and defending strategic choices. Further, they will be more firmly resolute in supporting you when the chips are down.

Educate Your Board

Leadership and learning are inseparable. Yet many CEOs still take the "mushroom" approach to their boards: keep them in the dark and cover them with manure. It is impossible to govern effectively in today's environment unless the members of the board have equal levels of understanding about the issues at hand.

Effective boards require that their members attend governance education sessions as a condition of reappointment to additional terms of office. They require attendance at the annual board retreat, which always has an educational component. They build mini-education sessions into each board meeting. They put their new trustees through a mandatory, rigorous board orientation process. They assign mentors to the new board members for their first year. And they match their governance educational curriculum to the organization's strategic issues.

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Consider Compensating Your Board

Board compensation, in and of itself, will do nothing to improve governance effectiveness. In fact, it may make board performance worse. However, board compensation combined with more stringent, formal performance standards for board members; serious individual board member performance evaluation; and a willingness to not renew a board member's term or to remove a board member from the board for poor performance will result in much more effective governance. Compensation makes it easier to hold board members accountable for their performance and to expect them to give more of themselves and their time to governance.

Although the concept of board compensation is clearly complex, challenging, and controversial, the time has come to explicitly and honestly consider it.

Conclusion

Governance reforms are upon us in healthcare, driving the need for more active, thoughtful, and accountable boards. You and your board must, as this article has attempted to do, identify and review both the key challenges to, as well as elements of a more effective model for, governance. To keep your board ahead of the curve and moving toward best practices governance will require a willingness to explore challenging issues and ask uncomfortable questions. You and your board can start by acknowledging the reality that the model and quality of governance that was sufficient to get your organization where it is today will be insufficient to get it where it needs to be in the future.

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