

# Advancing the public accountability of nonprofit health care organizations

## GUIDELINES ON GOVERNANCE PRACTICES



### The Environment

There has been significant scrutiny recently of for-profit corporate directors, emphasizing their duties of care and loyalty, culminating in the Sarbanes-Oxley Act, SEC recommendations, NYSE rulings, and many blue-ribbon pronouncements. There also have been a few recent scandals involving failure of governance by nonprofit health care organizations that have resulted in state regulatory interventions.

### The Challenge

While nonprofit health care organizations have different missions than their for-profit counterparts, serving in addition to their patients or members the broader community rather than stockholders, it would be a mistake to ignore the new governance requirements and recommendations for for-profit companies. Many of these reforms are becoming increasingly viewed in both the public and private sectors as relevant to many nonprofit organizations. Pressures for their adoption or adaptation by nonprofit health care organizations will increase from a variety of sources—state attorneys general and insurance commissioners, the IRS, federal and state legislators, donors, business partners, companies providing board liability insurance, voluntary accreditation organizations, institutional associations and professional societies, the media, and current and prospective board members themselves.

Because of their unique missions, however, nonprofit<sup>1</sup> health care organizations must do more than just meet these demands for greater governance oversight, board independence, and transparency. Their boards also have the fiduciary responsibility to approve plans and budgets for community benefit programs,<sup>2</sup> monitor their progress, and assess and report to the public on their costs and results. Excellence in other performance dimensions, especially in patient safety and quality with proven linkages to cost savings, can augment the resources available for the provision of other social benefits to the community, including but not necessarily limited to improvements in health care access for at-risk and underserved population groups.

### Purpose of This Report

The Alliance intends that the ideas and concepts presented in this document be used as a tool to motivate and enable nonprofit health care delivery and financing organizations to improve their governance practices. The guidelines are based on the recommendations of Alliance members, numerous professionals and panels in the public and private sectors, and the highly regarded Boardroom Consultants.

### Special Notes

Since the bylaws, organization structures and other circumstances of individual nonprofit health care organizations vary from one community to the next, the guidelines will not be a perfect fit in each instance and must not be construed as prescriptive standards. Rather, they provide a pathway to examining and continuously improving governance. Each organization will need to adapt them to its own needs and situation, and should consult legal counsel before and during their implementation.

In this document the term “Director” is used to refer to Board members, in order to help set the tone that they must be fully engaged, assertive, and accountable in carrying out their fiduciary responsibilities. For simplicity’s sake, these guidelines assume one tier of governance. Organizations with more than one tier, with differing roles, responsibilities, and authority at each level, will need to interpret and apply these guidelines accordingly. Similarly, these guidelines assume ultimate authority residing in the Board for decisions such as selection of its members, whereas for some nonprofit health care organizations a corporation membership, policyholders, consumer group, or other legally constituted body has such authority.

## GUIDELINES

### I. Mission

- A. The Board strives to meet the short and longer-term needs of its community as defined in statements of purpose, mission, vision, and values, and in organizational plans, recognizing that without continuity of the organization there is no mission.
- B. The Board aspires, for itself and the organization, to the highest standards of ethical conduct, doing what it says and maintaining full compliance with the laws, rules, and regulations that govern its services and business.
- C. The Board reviews its statements of purpose, mission, vision, and values, as well as bylaws, at regular intervals, reaffirming or modifying them as appropriate.
- D. The Board ensures that regular reports are made to the public with accuracy and transparency on the organization’s mission, programs and services, goals, and performance (including community benefits, safety and quality, customer service, and audited financial statements), as well as executive and any Board compensation.

### II. Corporate Governance

- A. The Board ensures that the services, property, and affairs are well managed.
- B. The Board ensures that it is well informed through discussions in Board meetings with the Chief Executive Officer (CEO) and other officers, by requesting and reviewing needed materials, by visiting facilities, through discussions in meetings of Board committees, and by other activities and interactions between meetings.
- C. The Board ensures that the information brought to it is relevant, clear, concise, and accurate, and is provided sufficiently in advance of meetings to allow for meaningful Board understanding, analysis, and decision making.
- D. The Board ensures that minutes are recorded and approved of all discussions and actions in all meetings of the Board and Board committees.

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<sup>1</sup> For simplicity’s sake the term “nonprofit” is used in this document; however, the guidelines are intended to also encompass non-investor-owned health care organizations that operate as nonprofits.

<sup>2</sup> Community benefits are business operational results or specific programs, activities and/or financial or in-kind contributions designed to: promote or provide needed services, improved access to needed services, improved quality and/or reduced costs, and/or improved health status, functional status, or quality of life for at-risk or underserved population groups or for the broader community.

### III. Overall Role, Responsibilities, and Composition of the Board of Directors

- A. The special mission of the organization requires active and effective Directors. Above all else, the Board provides for the perpetuity of the organization while benefiting the community as defined in the organization's mission statement. In all actions taken by the Board, the Directors are expected to exercise their reasonable business judgment in what they believe to be in the best interests of the organization and the community served.
- B. The Board of Directors, each of whom is elected by the full Board, is the ultimate decision-making body, responsible for the organization's direction and performance. It establishes the organization's mission, vision, values, and fundamental policies.
- C. The Board selects the CEO with the necessary leadership, managerial and personal attributes, including honesty, integrity, and community-benefits orientation, to conduct the organization's operations consistent with the Board's directives.
- D. Unless provisions have been made to eliminate any potential conflicts of interest, such as the appointment of an independent Lead or Convenor Director, the positions of Chair of the Board and CEO are separate.
- E. The Board acts as a coach and mentor for the CEO and executive management more generally while holding them accountable, overseeing and supporting performance through approval of and monitoring progress and results on goals, plans, and budgets. The ability of the Board to effectively monitor the performance of management is achieved by the presence of outside Directors of stature, who understand sound management practices and who are knowledgeable about or have the ability to learn the facets of health care in which the organization is engaged.
- F. The Board plans for succession to the position of Chair of the Board, other Board positions, and the position of Chief Executive Officer.

### IV. Independence and Qualification of Directors

- A. The Board of Directors adopts a formal set of Director Qualification Standards with respect to the determination of Director independence. To be considered independent, a Director must be determined, by resolution of the Board as a whole, after due deliberation, to have no material relationship, as defined in its Director Qualification Standards, with the organization other than as a Director. For instance, executive officers of the organization are not permitted to serve as Directors of a company that concurrently employs a Director of the organization. In each case, the Board broadly considers all relevant facts and circumstances. (Note: For those who may be interested, see the Appendix for examples of ways in which some organizations have defined "material relationships.")
- B. A clear majority of the members of the Board meet its criteria for independence and any other applicable laws, rules, and regulations regarding independence in effect from time to time.
- C. Candidates are selected for their character, community benefits orientation, judgment, diversity of experience, overall competence and acumen, and their ability to exercise due care and loyalty to the organization and its mission. Experience and acumen may include scientific, financial, managerial or other technical expertise, prior government service, and familiarity with national issues affecting health care.
- D. The number of other public or private company boards on which a Director may serve is subject to a case-by-case review by the committee responsible for governance performance and nominations, in order to ensure that each Director is able to devote sufficient time to perform his or her duties as a Director and to ensure lack of conflict.
- E. Except in unusual circumstances, the CEO is a voting member of the Board in order to help foster a teamwork relationship.

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<sup>3</sup> For some nonprofit health care organizations a corporation membership, policyholders, consumer group, or other legally constituted body makes the final selection of Board members.

## V. Number and Selection of Board Members

- A. The full Board has final approval of the policy on Board size and on the selection of specific Board members.
- B. As a matter of policy, the number of Directors does not exceed a size that can function efficiently as a body and is not less than the number needed to effectively conduct the business of the Board's committees.
- C. Current Directors are evaluated, nominated and reelected, or not renominated, at the discretion of the Board of Directors.
- D. The Board has policies and procedures for removal of non-performing Board members.
- E. The committee responsible for governance performance and nominations assists the full Board by considering and making recommendations to the Board concerning the appropriate size and composition of the Board, the overall number and length of Board meetings needed to function efficiently and effectively, the best candidates to fill new positions created by expansion or vacancies that occur due to resignation, retirement, or other reasons, and any major performance deficiencies of current Board members. In identifying candidates to fill new or vacant positions on the Board, the committee takes into consideration the current composition of the Board and its diversity (culture, expertise, experience, and perspective), unmet needs, and candidates' relative abilities to meet those needs. Depending on need and the availability of resources, a board search firm may be engaged to assist the committee in such areas as defining qualifications, finding potential candidates, and objectively screening them. The committee interviews face-to-face those candidates whom it intends to recommend to the full Board for approval.

## VI. Term Limits or Renewable Terms

- A. In order to help ensure effective Director participation and contribution, the organization has either term limits for Directors (for example, a maximum of three consecutive three-year terms) or terms that are renewable subject to an affirmative finding regarding the individual Director's performance.

## VII. Board Committees

- A. It is the general policy of the organization that all major decisions be considered by the Board as a whole. The organization has standing committees responsible for audit, compensation (or human resources), and governance performance and nominations, with additional committees limited to only those considered to be essential to, or required for, the effective operation of the organization (e.g., community benefits, planning, finance, quality, corporate compliance).
- B. Except in unusual circumstances, all members of the standing committees (other than the executive committee if one exists), meet the Board's standards for independence, as well as any other applicable laws, rules, or regulations regarding independence.
- C. The standing committee chairs and other members are appointed by the Board or Board Chair, taking into consideration the recommendations of the standing committee responsible for governance performance and nominations, after consultation with the individual Directors. Standing committee chairs and memberships are rotated periodically.
- D. Each standing committee has its own written charter that complies with general standards and with applicable laws, rules, and regulations. The charter sets forth the mission, goals, and responsibilities of the committee as well as qualifications for committee membership, procedures for committee member appointment and removal, committee structure and operations, and reporting to the Board.
- E. The chair of each standing committee, in consultation with executive management and the committee members, determines the frequency, length, and agendas of the committee's meetings consistent with any requirements set forth in the committee's charter. At the beginning of the year each committee establishes a schedule of agenda subjects to be discussed during the year, to the degree these can be foreseen. The agenda and other relevant information for each committee meeting are furnished to all members in advance of the meeting. Each independent Director may attend any meeting of any standing committee, whether or not he or she is a member of that committee, except in the case of the executive committee if one exists, where permission to attend is requested in advance.

F. All Board standing committees have the power to hire and fire needed independent advisors (e.g., legal, financial, compensation). Except in unusual circumstances, these decisions are reached jointly with executive management in the spirit of teamwork.

## VIII. Board Meetings

- A. Directors are expected to regularly attend Board meetings and meetings of committees and subcommittees on which they serve, and to spend the time needed and meet as frequently as necessary to properly discharge their responsibilities.
- B. The Chair (or Lead/Convenor Director) and the CEO establish a calendar of standard agenda items to be discussed at each Board meeting scheduled to be held over the course of the ensuing year, and also establish the agenda for each Board meeting, with the understanding that certain items pertinent to the policy-making, advisory, and monitoring functions of the Board be brought to it at appropriate intervals by the Chair and the CEO for review and/or decision. Agenda items that fall within the scope of responsibilities of a Board committee are reviewed with the chair of that committee.
- C. For purposes of preserving the Board's independence as well as ensuring clear and candid communication among the Board members and with executive management, at least several times a year on a prescheduled basis, the independent Directors meet in executive session without the presence of Management. The Board Chair or a designated Lead/Covenor Director presides at the executive sessions.

## IX. Strategic Planning

- A. The Board approves on a regular basis the organization's multiyear strategic plan as well as the annual operating plan and budgets developed by executive management, with review of the strategic plan at least once a year for any needed major adjustments. Community benefits programs and services are explicitly described in plans and budgets.

B. Board meetings are primarily devoted to important strategic and policy matters, including community benefits priorities.

## X. Communications

- A. The Board Chair (or Lead/Convenor Director) and/or the CEO are responsible for ensuring the establishment and maintenance of effective communications with the media and with the organization's key stakeholder groups, e.g., patients and other customers, employees, community leaders or groups, suppliers, creditors, governmental entities, organizational partners.
- B. The CEO and/or other designated executives are the primary spokespersons for the organization. In exceptional cases, individual Board members meet or otherwise communicate with various stakeholders that are involved with the organization, subject to prior consultation with executive management.

## XI. Code of Conduct and Corporate Responsibility

- A. A code of conduct and corporate responsibility program are developed by executive management and approved by the Board to support the organization's purpose, mission, vision, and values, providing ethical standards and a comprehensive process that are intended to ensure: compliance with all governance policies and procedures; compliance with all areas of professional conduct, including employment policies; an open relationship among colleagues that contributes to good business conduct, including protecting individuals against recrimination for reporting potential violations in the code of conduct or of the law; avoidance of conflicts of interest (with zero tolerance for self-dealing); protection of intellectual property and confidential information; and an abiding belief in the integrity of individuals.
- B. Where separate codes of conduct are established for Directors, employees, temporary workers, and other independent contractors or consultants to enhance their relevance, such codes are consistent in all important respects.

- C. The Board reviews a report by management at least annually on the performance of the organization's code of conduct/corporate responsibility program.

## **XII. Auditing**

- A. The committee responsible for audit has the sole authority to select, direct, retain, and terminate independent auditors.
- B. This committee reviews at least annually an independent audit report, and periodically meets separately and jointly with management, internal auditors, and the independent auditor.
- C. This committee establishes policies for: preapproval of any non-audit services to be provided by the independent auditor; rotation of the lead auditor, or the partner responsible for reviewing the audit, at least every five years; rotation of the audit firm, at least every 10 years; establishment and maintenance of an internal audit function; and CEO and principal financial officer certification of financial reports presented to the Board, the public, and governmental bodies.

## **XIII. Director Access to Executive Management and Other Employees**

- A. Directors have full and free access to executive management and other employees to become more knowledgeable about the organization and its people. Except in unusual circumstances where a sensitive issue needs to bypass normal channels or where particular managers or staff have Board or Board committee liaison roles, contacts by Board members are arranged through the CEO's office or other staff assigned to support the Board.
- B. The Board welcomes regular attendance at each Board meeting by selected members of executive management. If the CEO wishes to have additional personnel attendees on a regular basis, this suggestion is brought to the Board for approval.

## **XIV. Director Orientation and Development**

- A. The Board, taking into consideration the recommendations of the committee responsible for governance performance and nominations, provides for an orientation program for new Directors and a development program for all Directors. These programs include presentations by executive management on the organization's mission, structure, significant challenges and opportunities and strategic plans related thereto, code of conduct and corporate responsibility program, and internal and external auditing processes.
- B. The orientation program includes visits to significant facilities, to the extent practical.
- C. All Directors are expected to participate in their orientation and development programs.

## **XV. Succession Planning**

- A. The Board plans for succession to the position of Chair (or Lead/Convenor Director) of the Board, other Board positions, and the position of the Chief Executive Officer.
- B. The committee responsible for governance performance and nominations makes a report at designated intervals to the Board on succession planning for the Board Chair (or Lead/Convenor Director), taking into account that individual's assessment of potential successors, and for other Board positions.
- C. The committee responsible for compensation (or human resources) makes a report at designated intervals to the Board on succession planning for the CEO position, taking into consideration the CEO's assessment of potential successors. The CEO meets periodically with this committee in order to make available his or her recommendations and evaluations of potential successors, along with a review of any development plans recommended for such individuals. It is fully understood that it is ultimately the responsibility of the Board to make these succession decisions, not the CEO.

## **XVI. Board Chair and CEO Goals, Performance Assessment, and Compensation**

- A. The Board sets annual performance goals for the Board Chair (or Lead/Convenor Director) and evaluates his or her performance against such goals.
- B. The Board may provide an appropriate stipend to the Board Chair (or Lead/Convenor Director), one or more standing committee chairs, and/or other members of the Board in order to attract the best possible individuals and compensate them for their time and efforts in an era of heightened public accountability.
- C. The Board sets annual and long-range performance goals for the CEO, evaluates his or her performance against such goals, and determines appropriate compensation, consistent with the organization's needs, expectations, and market conditions.
- D. The committee responsible for governance performance and nominations makes an annual report to the Board on goals and performance of the Board Chair (or Lead/Convenor Director), taking into consideration that individual's self-assessment and recommendations.
- E. The committee responsible for compensation (or human resources) makes an annual report to the Board on goals, performance, and compensation for the CEO, taking into consideration the CEO's self-assessment and recommendations. The CEO's goals, assessment, and compensation reflect and balance all key dimensions of performance, including community benefits.
- F. These annual reports are reviewed for approval or modification by the independent Directors of the Board at a meeting or executive session of that group.
- G. The Board ensures the full public disclosure of all compensation of top executives and any Board member compensation.

## **XVII. Evaluation of Board Performance**

- A. The committee responsible for governance performance and nominations conducts an annual review of Board performance, in accordance with guidelines recommended by the committee and approved by the Board.

- B. The annual review includes: an overview of the role of the Board and its performance; the role of the Board's committees and their performance; the current talent base of the Board and its committees and competencies needed in the future; and an individual assessment of each Director's skills, areas of expertise, other competencies; qualification as independent under its standards and any other applicable laws, rules, and regulations, consideration of any changes in a Director's responsibilities that may have occurred since the Director was first elected to the Board, and such other factors as may be determined by the committee to be appropriate for review.
- C. The results of the committee's annual review of Board performance, and any recommended actions to improve performance of the Board as a whole, individual Board committees, or individual members, are summarized and presented to the Board for review and approval.

## **APPENDIX**

EXAMPLES OF SPECIFIC CRITERIA BEING USED BY SOME ORGANIZATIONS FOR DETERMINING THAT A CURRENT OR POTENTIAL BOARD MEMBER HAS A MATERIAL RELATIONSHIP AND IS NOT INDEPENDENT

### **Recentness of Relationship (Look-Back Period)**

Within previous three years (NYSE and NASDAQ)

Within previous five years (GE, Richard Kusserow)

Within previous two years (American Law Institute)

### **Employment or Other Direct Compensation Relationship**

The Director has been an employee of the organization<sup>1</sup> (NYSE, NASDAQ, and American Law Institute).

An immediate family member<sup>2</sup> is an executive officer of the organization (NYSE and NASDAQ).

The Director or immediate family member has received more than \$100,000 in compensation during the year, other than any Director fees, pensions, or other deferred compensation from prior service (NYSE).

The Director or family member has received during the year more than \$60,000 in direct compensation, excluding any Director fees, deferred compensation, and in the case of a family member, compensation as a non-executive employee (NASDAQ).

The Director has been an employee of another company or an immediate family member has been an officer of another company on whose board of directors an executive of the organization serves (GE).

The Director or family member has been employed as an executive officer of another company on whose board compensation committee an executive of the organization serves (NYSE and NASDAQ).

### **Auditing Services Relationship**

The Director or family member is affiliated with or employed in a professional capacity by a present or former auditor of the organization (NYSE).

The Director or family member is a current partner of the organization's outside auditor (or was a partner or employee of the organization's outside auditor), and worked on the organization's audit (NASDAQ).

### **Legal and/or Investment Services Relationship**

The Director is affiliated in a professional capacity with a law firm that has been the primary legal advisor to the organization with respect to general corporate law matters or with an investment firm that has been retained by the organization in an advisory capacity or that has acted as a managing investor of the organization's funds or as a managing underwriter of an issuer of the organization's bonds or other securities (American Law Institute).

### **Other Financial Relationships**

The Director has been an executive officer or an employee, or a family member has been an executive officer, of a company that receives payments from, or makes payments to, the organization for properties or services in an amount which in any single year exceeds the greater of \$1,000,000 or 2% of the company's consolidated gross revenues. Any charitable contributions are excluded but must be disclosed if they exceed this threshold (NYSE).

The Director or a family member has been a partner, controlling stockholder, or executive officer of a company that receives payments from, or makes payments to, the organization for properties or services in an amount which in any single year exceeds the greater of \$200,000 or 5% of the recipient's consolidated gross revenues. Payments arising solely from investments in the organization's securities are excluded as well as nondiscretionary charitable contribution matching programs (NYSE).

The Director, or a company that he/she owns or has an equity interest in, receives from or makes commercial payments to the organization that exceed \$200,000, when multiplied by the Director's percentage equity interest. Or, the Director is the principal manager of a company that receives from or makes commercial payments to the organization that exceed the greater of \$200,000 or 5% of the organization's consolidated gross revenues (American Law Institute).

The Director is an executive officer of a company that does business with the organization, and the annual sales to, or purchases from, the organization are 1% or more of the annual revenues of the other company (GE).

The Director is an executive officer of a company that is indebted to the organization, or to which the organization is indebted, and the amount of either company's indebtedness to the other is greater than the total consolidated assets of the company where he/she serves as an executive officer (GE).

The Director serves as an officer, director, or trustee of a charitable body where the organization's discretionary charitable contributions are 1% or more of that body's charitable receipts (GE).

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<sup>1</sup> The organization includes its parent and any subsidiaries.

<sup>2</sup> NYSE defines immediate family member to include spouse, parents, children, siblings, in-laws (mother, father, sons, daughters, brothers, sisters), and anyone else sharing the Director's home other than an employed domestic. The SEC defines immediate family to include only spouse, minor children or stepchildren, or children or stepchildren sharing the Director's home.