MEASURING NONPROFIT HEALTHCARE GOVERNANCE EFFECTIVENESS: HOW DO YOU KNOW A GOOD THING WHEN YOU SEE IT?

TEN EASY MEASURES OF NONPROFIT BOARD CONDUCT

L. Edward Bryant, Jr., Gardner, Carton & Douglas
Peter D. Jacobson, University of Michigan

A white paper prepared for the National Center for Healthcare Leadership
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>1</td>
</tr>
<tr>
<td>The Tradition of Volunteerism</td>
<td>2</td>
</tr>
<tr>
<td>The Need for Governance Standards</td>
<td>2</td>
</tr>
<tr>
<td>The First Measurement Technique – Meeting Legal Requirements</td>
<td>4</td>
</tr>
<tr>
<td>The Second Measurement Technique – Compliance Mentality</td>
<td>4</td>
</tr>
<tr>
<td>The Third Measurement Technique – CGE</td>
<td>5</td>
</tr>
<tr>
<td>The Fourth Measurement Technique – Use of Dashboards</td>
<td>5</td>
</tr>
<tr>
<td>The Fifth Measurement Technique – Agenda Practice</td>
<td>7</td>
</tr>
<tr>
<td>The Sixth Measurement Technique – Conflicts and Dualities of Interest</td>
<td>7</td>
</tr>
<tr>
<td>The Seventh Measurement Technique – Non-Episodic Corporate Governance Committee</td>
<td>9</td>
</tr>
<tr>
<td>The Eighth Measurement Technique – Voluntary Sarbanes-Oxley Compliance</td>
<td>9</td>
</tr>
<tr>
<td>The Ninth Measurement Technique – CEO Evaluation</td>
<td>10</td>
</tr>
<tr>
<td>The Tenth Measurement Technique – Board Planning and Evaluation</td>
<td>11</td>
</tr>
<tr>
<td>Next Steps</td>
<td>12</td>
</tr>
<tr>
<td>Conclusion</td>
<td>12</td>
</tr>
</tbody>
</table>
MEASURING NONPROFIT HEALTH CARE GOVERNANCE EFFECTIVENESS:
HOW DO YOU KNOW A GOOD THING WHEN YOU SEE IT?
TEN EASY MEASURES OF NONPROFIT BOARD CONDUCT

Introduction
While it may not be easy to achieve, the beauty of effective governance in a for-profit enterprise is that it is a recognizable commodity. The balance sheet is the principal scorecard. If the stock price is rising, healthy dividends are being paid regularly, market share is increasing, pension obligations are funded, and (in the post-Enron era) the company executives are not under indictment for cooking the books, the board of directors is, in all likelihood, doing its job well. When the legal duty is to look out for the shareholders' interests, measurement of effectiveness is relatively simple.¹

In the nonprofit world, on the other hand, and especially in health care, effective governance is not quite that easy to discern or to measure. And it's definitely getting harder to recognize. This article is written for those people and organizations that have an interest in whether or not a given nonprofit (also "not-for-profit" or "NFP") health care entity has effective governance. Those parties include at least the following:

- Recognized corporate "sponsors" or corporate members
- State attorneys general
- The Internal Revenue Service
- The Medicare Program's Office of Inspector General
- Hospital licensing authorities
- The Joint Commission on Accreditation of Health Care Organizations
- Bond rating agencies
- Bond counsel
- Bond underwriters
- Bondholders and other major creditors
- Insurers
- The Medical Staff
- Non-physician clinicians
- Hospital employees and pensioners
- Senior management
- Subsidiary or controlled entities
- Major donors of charitable gifts
- The public, including consumers and members of the community
- Joint venturers and would-be joint venturers
- Competing organizations
- Potential board members
- The Board itself

¹ This has not necessarily always been true. But with the legal reforms described below, it should be today. Until the accounting fraud was exposed for a number of high visibility public companies, it certainly appeared that they were well-governed when in fact they were not.
The perspective of all of these people who care should be very similar when they seek to evaluate the board of a given nonprofit health care organization, though some obviously have a more “financial flavor” to their interest. It is worth remembering that not everyone defines an optimally effective not-for-profit (“NFP”) board of directors or trustees in the same way. Religious sponsors and members of the community may want more emphasis on mission than on the bond rating. Senior managers and medical staff leaders may prefer boards that don’t always ask “Why?” or that delegate more policy-making to them. The bond underwriters may prefer boards that don’t argue for “flexibility” in bond covenants so the bonds can be sold faster. Objectively, these illustrations point out that there are both conflicts of interest and dualities of interest between nonprofit boards and many of those with whom they deal. Effective boards find workable ways to assure that the interests of the nonprofit organization and of the public are given the number one priority in such situations.

Because the literature is somewhat lacking on objective methodologies for evaluating voluntary or NFP board effectiveness, this paper aims at contributing to filling that void. However, getting to measurement is a two-step process. Particularly as regards hospitals, health systems, and other nonprofit healthcare organizations, the premise of this paper is that effectiveness measurement can indeed be accomplished by benchmarking standards of board conduct against consensus board “best practices.” Defining best practices is thus the first step in attempting to measure effectiveness.

The Tradition of Volunteerism
American volunteerism, literally "invented" by Benjamin Franklin in the 1750s and alertly analyzed for its socio-political uniqueness by Alexis de Tocqueville in his *Democracy in America* in the 1820s, is the specific mechanism being evaluated. Spawned from American grassroots morés and periodically enhanced (or corrupted) by the mix of law and politics variously in the 50 states, not-for-profit corporations today house thousands of hospitals, health systems, and their affiliates. These entities are “owned” by the public and controlled on its behalf by fiduciaries known interchangeably as directors and trustees. They are overseen directly by the 50 attorneys general and by concerned citizens whose interests are, by definition, non-proprietary.

Nonprofit corporations evolved, under state law, from private associations established to avoid public or religious control and from charitable trusts established to benefit the public. This is why the directors of such corporations are also often known as trustees. Trustees' legal obligations are "fiduciary" obligations, *i.e.*, owed to others. Because, under our legal system, trusts are also historically overseen by courts, many of the legal standards for nonprofit governance were originally articulated in court cases. And because court cases are usually brought to allege that someone has mis-performed, either negligently (misfeasance) or intentionally (malfeasance), much of the law of nonprofit corporations is phrased as “thou shalt not…..” The two general legal duties of a nonprofit director are the duties of loyalty2 and of care. The specifics for defining these duties all too often grow out of cases involving fiduciaries who were disloyal or uncaring of the interests of the public. More troublesome is the fact that fiduciary duty law is underdeveloped and often ambiguous. The incompleteness of fiduciary law and its lack of clear standards permit considerable latitude for board decisions (such as the business judgment rule), but open the trustees to judicial second-guessing as to whether the duty of loyalty was met.

The Need for Governance Standards
The poster child for how not to govern a nonprofit organization in the last decade was, without a doubt, the

---

2 Some commentators add a duty of obedience to state corporate purposes as a third fundamental duty. This is encompassed within the duty of loyalty and need not be singled out legally.
Allegheny Health, Education and Research Foundation ("AHERF"). AHERF filed for Chapter 11 bankruptcy protection in July of 1998 after many years as a dominant player in nonprofit health care in both the Pittsburgh and Philadelphia markets. Published after-the-fact analysis concluded that the CEO and board chair, engaging in very clever and deceptive “agenda practice” over a long period of time, effectively excluded the board and its executive committee from their policy-making roles.

This clear pattern resulted, after the bankruptcy filing, in the regular invoking by AHERF board members of the well-known “Sgt. Schultz defense” to excuse their inaction: "I know nothing.” True or not, this defense in turn illustrates what is always lacking in such boards (often composed – as was the AHERF board – of captains of industry and leading citizens), namely: the personal courage to look a fellow trustee in the eye and ask the tough question. That question may be about a conflict or a duality of interest or about whether there are viable alternative courses of action or whether a given factor was considered appropriately. It takes courage to ask such questions of friends and colleagues on a board, but the absence of such courage accounts for significant instances of governance misfeasance. Fiduciary director/trustees are clearly not serving on their own behalf. They wear the NFP director/trustee hat on behalf of the public. This third-party beneficiary relationship cannot consistently be ignored without concern. Federal law provides through the Volunteer Protection Act that NFP volunteers being paid less than $500 per year are immune from personal liability for acts taken in good faith. Most states have similar laws for volunteer director/trustees/officers of NFP organizations. The important inquiry, however, is "What is in good faith?"

It seems just a matter of time until a court with the right set of facts will conclude that "I know nothing" as a fiduciary's defense is inconsistent with a fiduciary's duties and will conclude further that the know-nothing trustee is not acting in good faith. The plaintiff in such a case will undoubtedly be an attorney general running for higher office, but the development seems at this point inexorable. CEOs and board members should therefore anticipate such scrutiny and protect themselves and the institution from personal or institutional liability. It will be (or has been) anticipated by directors and officers liability insurance carriers, which will bear the initial brunt of any such development.

Set forth below are ten general standards of conduct – best practices – for NFP governance, each of which is capable of being measured with the right instrument. These practices have nothing whatsoever to do with the average net worth of the members of the board of trustees and little or no correlation with the organization's debt-to-equity ratio. They apply equally to large academic medical centers and the small community hospitals.

Additional study and research are necessary to justify any broader statements, such as one asserting that compliance with these best practices will always produce a financially sound organization. Indeed, considerable research will be required to develop and test objective measures of performance. The sole assertion, instead, is that boards, which adhere to best practices, are constantly becoming more effective as volunteer policy-makers and will establish a documented record of attempting to meet their fiduciary duties. To the extent that such effectiveness produces group confidence and fewer instances of negligence in decision-making, the organization, the public it serves and the director/trustee are all made better for the experience.

---

3 See What Boards Can Learn from the Allegheny Bankruptcy – The Legal Responsibilities of Nonprofit Organizations, Boards, and Executive Officers, The Governance Institute, Summer 1999, authored by a co-author of this white paper.

4 Arguably, the recent criminal convictions for executives of WorldCom and Tyco indicate that the know-nothing defense is also a losing strategy in the for-profit world.
The First Measurement Technique – Meeting Legal Requirements

The first, and most fundamental, measuring stick for evaluating a nonprofit board is whether it complies with those express requirements of law (judicial, legislative or regulatory law) indicating what the organization and the board should and should not do. Though this is not always evident, good “due diligence,” a business-like process for learning what is necessary to learn about the business such as using the right checklists and interview techniques to gather information before making decisions, will usually answer the critical fiduciary duty questions about legality of organization and conduct.

The average nonprofit director or nominee to a nonprofit board of directors would ordinarily not be in the position to commission a comprehensive due diligence review of the organization's operations. That would cost money the volunteer is not able to afford. Those who work to rate or issue bonds, on the other hand, perform such reviews routinely. Usually, however, the hospital or health system pays for the review anyway. At a minimum, therefore, the board should always require that one of its committees have access to all such due diligence reports and any responses from senior management. In fact, for out-of-the-ordinary transactions, the board or a board committee should be involved in framing the due diligence questions posed.5

This unique opportunity is usually wasted entirely as a board education method unless a substantial problem surfaces which must be discussed with the board finance or audit committee. Indeed, there are other outsiders who look routinely at health care organizations for purposes of evaluating whether they are following the applicable laws. These include licensure authorities, accreditation agencies, certification organizations, insurers, and law enforcement authorities following complaints or allegations. Some of these reviews are recurring and routine; others are episodic and very non-routine. All of them produce written reports and, usually, an institutional obligation to respond in writing to such reports, usually with what are called "plans of correction" for any deficiencies found.

Most boards of directors do not see either these reports or management's written responses. At the least, monitoring such processes and reports should be assigned to an appropriate board committee, with the conclusions and sticking points being shared with the full board. This is not micromanagement by the board. It is a combination of senior management evaluation, meeting fiduciary duties, and basic due diligence. Being duly diligent about the status of one's organization is the first line of responsible governance, and board monitoring of such third-party evaluations is easily measurable if it exists.

The Second Measurement Technique – Compliance Mentality

Nothing is quite so difficult as proving that someone is either not doing something that is proper or actually concealing improper behavior. But, when it comes down to basics, that is exactly what conscientious hospital board members need to ask — of hospital senior management, of their medical staff and of each other.

Enter the concept of corporate compliance. While the Medicare Program would like to take credit for inventing this technique, for-profit corporate America has known about corporate compliance for many years. It is a process of honest self-scrutiny, often involving objective third-party evaluators in an attorney-client privileged format,6 so

---

5 This is not to suggest that NFP boards replace those who are trained to look at a transaction for its financial or legal feasibility. Governance feasibility demands that it should ask, “What could go wrong?” as well as “How does this organization come out ahead?”
6 The privilege will only be assertable if strict standards are followed as an effort to avoid potential litigation through use of outside counsel and the privilege is not thereafter waived by disclosure outside the designated "corporate control group."
that an organization finds out about its legal deficiencies from an objective “friend” rather than a prosecutor or the news media. When done properly, it produces a confidential report that the board of directors or an appropriate board committee can study in depth and monitor steps taken in response.

Boards should insist that their institutions, led by senior management, develop a corporate compliance mentality in which legal shortcomings are routinely defined, identified, analyzed and corrected. Effective compliance mechanisms will in turn follow a compliance mentality. Establishing a compliance orientation signals all employees that the board takes its fiduciary duties seriously and will not tolerate shortcuts to maintaining a high quality organization. That mentality is a strong statement to patients, physicians, accreditors, and regulators about how the organization will be governed. A well-developed compliance program produces measurable legal risk management and constitutes another best practice of good governance. One mechanism for achieving the compliance mentality is to establish an internal auditing subcommittee of the board.

The Third Measurement Technique – Continuing Governance Education
Nothing is so sure in health care as change. The hospital trustee who began serving in the 1990s, even if well-oriented upon assuming office, needs constantly to be educated on the board's applicable duties and on the newest challenges in the health care industry. At board meetings, at retreats, at committee meetings, through regular publications and special announcements and by attending recognized seminars on health care issues, board members need “continuing governance education” (CGE) just as much as clinicians and managers need their continuing education. Since for the most part directors are not paid to do their jobs as volunteers, the task of CGE is often a very difficult one, for educator and student alike, involving both time and effort. Few do it well. It needs to be made easily available and a routine occurrence. The well-balanced board will also, of course, learn from each of its members as they perform their board service conscientiously. So, a director returning from an educational CGE event should share his or her learning and materials with the rest of the board.

But it should always be remembered that overly-deferential conduct is also dangerous to a board. There is reason behind the old saying that “War is too important to be entrusted to generals.” Similarly, medicine, law, banking, accounting, technology and hospital management are too important from a policy point of view to be entrusted to what may be the one physician, attorney, banker, CPA, technocrat, or hospital executive on the board. While everyone on a board can't be a master of everything, everyone can and should be the master of the tough policy question. The board that continuously educates itself is engaging in another measurable best practice. The board chair, the CEO, and the governance committee chair should together take the lead in assuring meaningful CGE for the entire board and not just its new members. Every board should have its formal and informal CGE calendar for each year, supplemented by having individual board members leading discussions after their attendance at CGE events. Participation in CGE functions is an easily measurable activity, which will pay immediate dividends.

The Fourth Measurement Technique – Use of Dashboards
Starting from the premise that all good hospital trustees are busy people, boards and especially board committees, should require that the hospital's management provide them with data and news that is “edible and digestible.” It is a well-known obfuscation technique to offer long and complex textual descriptions of proposed actions to make sure that objections will be difficult to articulate. Such obfuscation may be from management negligence or intentional tactics; neither is acceptable or effective governance.
"Dashboards" are the answer — graphics that display comparative performance indicators allowing a board to see at a glance the progress (or lack thereof) on those issues that the board has decided should be the organization’s priorities. Dashboards can also compare hospital "A" with its closest competitor or with a universe thought to be useful (e.g., all others in a metropolitan area or similarly situated). Comparisons can be even more useful when they are made with acknowledged industry "benchmarks," as long as the best known performance can be obtained for a truly comparable unit. Assisting the board in obtaining the right benchmarks for comparison is what good management does. With color coding, both superb performance and material deficiencies can be isolated easily. With the color gold representing greater than 3% over objectives, red representing a deficiency of greater than 3%, and green representing performance within 3% either direction from objectives, board members can see quickly what areas ought to be placed highest on the organization's remedial priority list. Each board committee should be given the right (if not the obligation) to designate one or more (but not too many) performance indicators to be displayed on the organization's governance dashboard on a monthly or quarterly basis. Financial indicators tend to dominate board dashboards because they are easier. But effective boards do not just do that which is easy. With Medicare and consumers now attempting to measure quality at every hospital, boards cannot overlook the value to them of also having such data, both comparatively and by trend line. Quality counts. Whatever counts can be handled in dashboard form.

As performance changes for the organization (in the right direction), educated boards will adopt new priorities to be displayed by the dashboard. This will also permit the board to log into the "accomplished" category those issues for which the dashboard has shown material progress. This is a very empowering exercise for a board, one that will cause it to be even more thoughtful about setting realistic goals and measuring progress in the future. It will also require good discussion about what benchmarks to use and with what competitors or universes the institution should be compared. Boards that master this process are the most effective of all boards. CGE will suggest new topics and allow trustees to understand and compare their own data more meaningfully.

Two final points should be made on the best practices value of dashboards. For a hospital board to "chart a course" or articulate a vision for the future, it must learn to study the possibilities and the "conditions precedent" to success more than just concentrating on past performance. This turns boards and board committees into forward-looking groups rather than just history-analysis groups. Dashboards help boards realize that there is or can be a direct result in performance from the policy decisions taken by those boards. Until boards reach this realization, their ventures into new programs or directions are more on faith than on the confidence that they can make it work.

The second point is that the use of dashboards is not micromanagement by the trustees. Rather, it is the essence of meeting the board's legal responsibility for overseeing how the organization is run. It is a methodology for identifying and measuring those priority objectives that the policy-makers have determined should exist. It is also an acknowledged way for governance to show it is evaluating management and its own oversight function without requiring that the board become bogged down in details. Appropriate and regular use of dashboards will build governance confidence and will easily distinguish those boards from the ones not using such governance best practices.

---

7 Those who doubt this proposition should consider the court's reaction to one board's failure to do so in In the Matter of Manhattan Eye, Ear & Throat Hospital v. Spitzer, 715 N.Y.S.2d 575 (N.Y. 1999). The court took governance to task when it, essentially, allowed an investment banking firm to make its policy decisions.

Copyright © 2005 L. Edward Bryant, Jr., Peter D. Jacobson, and the National Center for Health Care Leadership. All rights reserved. Pre-Publication Copy: This is for review purposes only and should not be cited, quoted, or distributed without permission of the NCHL and the original author(s).
The Fifth Measurement Technique – Agenda Practice

Best governance practices need not all be difficult to achieve. Some can be downright mundane, but are no less essential to the self-scrutiny process or to the concerns of external evaluators, such as those involved in the issuance of hospital bonds or the granting of accreditation. A fifth measurable technique includes the totality of practices perhaps best identified as "agenda practice." This often overlooked and underestimated arena includes:

- Clear agenda for board meetings with estimated time allocations.
- Clear supporting materials with alternatives given.
- Executive summaries for complex issues.
- Pre-drafted board resolutions.
- "Consent agenda" treatment for routine items, including routine committee reports.
- Declarations of conflicts and dualities at the outset of each board meeting.
- Written credentials for new speakers.
- Concise minutes, easily scanned.
- Executive sessions at each board meeting.
- Some form of evaluation of each meeting.
- At least annual comprehensive evaluation of the board's effectiveness by the board.
- Clear identification of attorney-client privileged or other privileged materials.
- Circulation of materials at least a week in advance of meetings.
- Appropriate use (but not over-use) of video and audio electronic meetings by some or all participants, to enhance attendance and to decrease travel time for regional or national boards.
- Programmed disclosure to entire board of all IRS Form 990 information (open to public).
- Some form of CGE, however brief, at each board meeting.
- Use of guest speakers at meals to utilize a "down time" opportunity.
- Clear identification of executive session minutes, separate from regular minutes.
- Parliamentary procedure at board meetings that encourages questions, seeks balanced presentations, and treats no good faith question as a "dumb" question, but fairly limits redundant and irrelevant discussion.\(^8\)

As the article cited at footnote 3 concludes, there are very specific methods for measuring whether a given board's agenda practices are at the "best practices" level. Similarly, due diligence scrutinizers can utilize these methods for risk management purposes. Particularly since these techniques are methods for avoiding the incredulous "I know nothing" board member defense, they should be studied and, where appropriate, adopted as prophylactic measures of board effectiveness.

The Sixth Measurement Technique – Conflicts and Dualities of Interest

If board members will just remember three simple rules about conflicts of interest, they will generally want to do the right things about conflicts. Those simple rules are:

1. Undisclosed conflicts are, by definition, not "in good faith." The lack of disclosure has the legal effect of nullifying all the directors' statutory immunities.

\(^8\) It is essential that governance enforces its rules and policies fairly and consistently. Failure to do so may impede appropriate board decisions. Board chairs should be nominated in part based upon this attitude toward open discussion of policy issues.
2. Undisclosed conflicts can, since 1996, produce substantial federal excise taxes on affected individuals who are corporate "insiders" and who obtain "excess benefits" from their organizations.

3. An apparent, but not real, conflict can cause almost as much trouble as a real one in terms of public embarrassment for individuals and NFP boards.

It is no accident that conflicts of interest for NFP insiders have caused substantial litigation, embarrassment, and statutory reform in recent years for NFP boards. Every outside agency – public and private – having authority over nonprofit organizations has expressed concern about the effects of conflicts of interest, especially in healthcare. These agencies include:

- The 50 Secretaries of State
- The 50 Attorneys General
- The Internal Revenue Service
- Accrediting agencies
- Licensing agencies
- Bonding or lending agencies
- Contracting organizations

In addition, elements within NFP health care organizations should routinely and appropriately consider whether conflicts exist and, if so, how they should be handled. Boards of directors, senior management teams, and hospital medical staffs, all insiders, know that conflicts of interest occur, but that they can be identified, discussed, and dealt with appropriately to neutralize their effects so the NFP organization is not disadvantaged. This requires that clear policies be adopted, that procedures be in place, and that they be enforced consistently.9

There are three principal measuring devices for accomplishing this end, namely:

1. A board-adopted written policy on conflicts and dualities that is enforced and which requires written periodic disclosures of both and that reminds all persons at each board meeting of the policy.10
2. A procedure which is followed identifying all insiders ("disqualified persons") under IRC § 4958 and following a procedure for every contract with each of them which establishes a "rebuttable presumption of reasonableness" under the IRS regulations.11
3. A governance committee of the board (see Section 7 below) which oversees the conflict/duality disclosure and resolution process and which recommends board actions to deal affirmatively with troublesome fact situations.

Each of these three mechanisms can easily be verified as to its existence and regular utilization. Agenda practice, including good minutes, is part of the conflicts prevention and resolution process and provides evidence of compliance. In addition, boards should keep track in their records of how specific issues involving conflicts of interest or alleged breaches of other fiduciary duties were resolved and why. With constant board member turnover, institutional memory of governance matters is tenuous unless steps are taken to retain knowledge.

---

9 Inconsistent enforcement of policies aimed at assuring corporate integrity would itself be a serious corporate compliance problem.
10 The IRS prefers that such policies be referred to in an organizational document, such as the corporate bylaws, so there is no doubt that all who deal with the organization are aware of its policy.
11 Such a legal presumption could only be overturned by evidence of fraudulent or otherwise criminal intent, an extremely difficult burden for the IRS.
Maintaining a “bank” of fiduciary decisions will provide guidance over time as to how best to resolve difficult governance challenges in the future. It also provides a CGE opportunity for meeting the board’s fiduciary responsibilities.

The Seventh Measurement Technique – Non-Episodic Corporate Governance Committee

In many NFP organizations, the annual report of the board nominating committee represents the only written evidence of deliberations regarding enhancement of the board and how it is functioning. However, the need to be able to measure improvement of the entity’s governance has produced the need for attention to nominations and many other closely-related activities other than as a finite annual episode. This in turn has led to the creation of board committees (termed “governance committees”) which meet regularly throughout the year and which deal with such matters as:

- Director/trustee/officer nominations.
- Preparation of a running chart of potential directors specifying the skills brought to the table by each candidate.
- Preparation of recommendations on skill sets needed by the board going forward, including priorities.
- Review of all conflicts and dualities disclosures and recommendations to the board when special action is required and a review of all IRC § 4958 transaction documentation.
- Annual review of and preparation of recommendations on corporate bylaws and procedural policies affecting governance for sufficiency and consistency.
- Preparation of recommendations for new director orientation and all CGE, both at board meetings and through special events, including board retreats.
- Preparation of recommendations on board evaluation of the board's effectiveness and of meeting effectiveness.
- Review of results of board and board meeting effectiveness evaluations.
- Review of effectiveness of structural relationships with controlled/majority-owned affiliates as to use of reserved powers.
- Review of all due diligence reports on the organization affecting or evaluating board effectiveness.
- Preparation of recommendations annually (may also be assigned to Executive Committee) on dashboard performance indicator changes to be made.
- Review of and preparation of recommendations on instances of violations of corporate confidentiality policy by officers and directors.
- Handling of other governance-related projects assigned by the board or Executive Committee.

This is not a make-work committee. Rather, it should be looked upon as an internal assessment committee to handle on a regular basis important matters that usually fall between the cracks. It is to make non-episodic that which is usually disjointed and episodic (annually or in crisis). A review of the committee’s minutes and of its recommendations to the board will tell whether and how well it is doing its job, thereby measuring the effectiveness of those whose principal reason for being is to measure and assure board effectiveness.

The Eighth Measurement Technique – Voluntary Sarbanes-Oxley Compliance

Except as to whistleblower protection, the landmark Sarbanes-Oxley Act ("SOA") hurriedly enacted by Congress to deal with the post-Enron world for publicly held corporations, does not apply to NFP organizations. But inasmuch as the public is being protected from the relatively unscutinized conduct of corporate insiders of
entities, which are imbued with a public interest, the SOA rationale clearly would apply. The SOA touchstone is independence of governance decision-making rather than decisions made to line someone's pockets. This is the precise objective of IRC § 4958, of IRC § 501(c)(3), of the Stark Law and the Medicare Antikickback Law.

Putting aside statutory mandates to the SEC to study certain issues and advise Congress, SOA established many regulatory mandates for scrutinizing publicly-held companies. Most of these mandates either require or empower individuals (directors, board committees, attorneys, auditors, etc.) to make disclosures about inappropriate relationships or to sanction them when they do not (loss of compensation, disqualification to serve or to practice). By taking away the ability of some to control information sub rosa, the independence of advice and of governance decision-making is enhanced. The effective NFP board, perhaps through its governance committee (described above), should study which of the SOA methodologies of scrutiny might appropriately warrant being adopted voluntarily. These include such easily identifiable steps as: (1) CEO and CFO certification of financial statements; (2) clarification of who should and should not serve on the board's Audit Committee; and (3) forfeiture of senior management incentive compensation if financial statements have to be restated. This is not to suggest that NFP healthcare providers should adopt all SOA mandates. But voluntary adoption of appropriate and fundamental SOA procedural mandates may be easily measured and are an especially timely method of evaluating board effectiveness.12

The Ninth Measurement Technique – CEO Evaluation

What should be the highest priority on an annual basis for the NFP board of directors is, ironically, often its lowest priority – documentation of the comprehensive annual evaluation of the organization’s CEO. Precisely because every board knows this should be a high priority, the board members are usually unwilling to admit that this is being done poorly. Particularly in those organizations in which the CEO has served many years and/or has acquired a tremendous positive reputation, volunteers whose tenure might be much shorter sometimes do not understand that their duty includes critiquing the person who may have come to personify the institution. But it does.

Because of the need to keep the details of the CEO evaluation private, it may turn out that this measure of board effectiveness is the most sensitive of them all. But nothing about the process or the outcome is so sensitive that it should be ignored or that its degree of effectiveness should not be measured.

Experience shows (1) that CEO evaluation is best coordinated through a board committee (usually the Executive Compensation Committee or the Executive Committee); (2) that all members of the board should be invited expressly to participate in an annual evaluation survey shortly after the end of the fiscal year;13 (3) that the evaluation should relate to board-established objectives for that year; (4) that there should be an opportunity for open-ended comments as well as ones responsive to specific questions; (5) that either or both of a year-end bonus or the next year’s base compensation increase, if any, ought to depend upon the performance evaluation; (6) that the board chair ought to sit with the CEO to share the evaluation; and (7) that the process ought not to be

12 As this paper is being finalized, the Panel on the Nonprofit Sector issued its 116 page report to Congress containing 120 recommendations "... for improving accountability and transparency of all not-for-profits." See "A Hire Standard," Modern Healthcare, June 27, 2005 at page 6. Responsible NFP boards will need to study these proposals closely and consider prophylactic measures seriously in the discharge of their fiduciary duty of care.

13 The entire board should also be advised as to the CEO’s annual compensation; if it will be in the IRS Form 990, it will be public, and board members don’t like to be surprised by having someone else ask them about something they should know.

Copyright © 2005 L. Edward Bryant, Jr., Peter D. Jacobson, and the National Center for Health Care Leadership. All rights reserved. Pre-Publication Copy: This is for review purposes only and should not be cited, quoted, or distributed without permission of the NCHL and the original author(s).
final without (a) the CEO's self-evaluation and (b) the CEO's reaction to the board's evaluation of him or her.

Unusual circumstances call sometimes for unusual evaluation techniques. But the board chair should always be willing and ready to justify any out-of-the-ordinary evaluative techniques, if thought necessary or desirable by the board or its delegated committee.

Certainly the foregoing seven elements of the recommended CEO evaluation process can be identified as to whether they occurred or not and when. In this sense, the measurement of board effectiveness will be almost entirely process-driven. Also capable of measurement (and highly important) is the issue of when the process was finished. If the organization has a calendar fiscal year, but the evaluation process takes until July, it is entirely questionable whether the evaluation can have much effect on the CEO's conduct in the five months remaining in that year. The effective board communicates promptly, as well as comprehensively, when it evaluates its CEO.

The Tenth Measurement Technique – Board Planning and Evaluation

This element of measurement of an NFP health care board's effectiveness has two components: (1) the measurement of the quantity and quality of the board's involvement in corporate planning for the future; and (2) the board's evaluation of itself. These are combined because each of the foregoing nine areas of conduct includes some form of planning for the institution, but no single one of them, by their nature, really asks whether the full board is invested in helping to plan the overall future of the organization.

In addressing the general issue of the board's self-analysis of whether it is doing a good job, both the immediate past and the future need to be included. To do otherwise would pose the question of how the board performed the last twelve months without asking if it knows where it is heading. In other words, whenever the board engages in self-scrutiny, the horizon ahead, not behind, is the important one, and the process behind the board will help measure the likelihood of future progress for the organization.

Board self-analysis should include what all directors/trustees think about: (a) their collective tackling of the foregoing nine measurable elements in the last year; (b) their collective mindset on the organization's prospects for the future; and (c) their individual contributions and/or misgivings about what each has done or not done for the NFP organization. In addition to short-answer questions, each director should be permitted an open-ended commentary as a means of encouraging frank and full participation in the board's (and the organization's) future.

Not to be confused with the annual self-analysis of a board of itself and its measures of effectiveness (usually occurring after year-end and after the annual board planning retreat), there is an important second element of measurable board self-scrutiny. This is the “single meeting evaluation.” The clear trend in health care board meetings is toward fewer, but better, meetings of the full board. Another trend is toward longer meetings, in order to be better and to accommodate more CGE. It is quite valuable for senior management, board leadership, ex officio participants, and newer directors/trustees to be given a single page questionnaire on the effectiveness of each meeting. The chair and the CEO simply cannot afford to wait a year to learn that a measurable part of the board is unhappy with the way meetings are conducted, planned or structured. This technique will also permit evaluation of the style and effectiveness of guest speakers, materials, and even the meals and other "arrangements." What is oftentimes simply glossed over is that effective boards don't like or appreciate ineffective meetings. Deficiencies corrected are palpable growth steps toward greater effectiveness.
Next Steps
This paper is prepared at the request of the National Center for Healthcare Leadership ("NCHL"). After NCHL has had an opportunity to discuss the foregoing suggestions, there are two interrelated follow-up items that should be addressed. The first is to develop a strategy to monitor and assess the implementation of these measures. Which of the ten strategies do organizations adopt; which ones are effective; and which are not.

Simultaneously, there is a growing need to develop and test NFP governance performance standards as applied to fiduciary duties. As noted earlier, this is an area of the law that is supposed to provide an accountability roadmap for governance decisions, but often does not because of the inadequate development of legal doctrine.14

While providing a more elaborate research agenda is beyond the scope of this article, it is important to remember that the performance standards set forth are not self-executing. Understanding whether and how the standards work in practice will be an essential component of improving healthcare governance and hence improving patient outcomes.

Conclusion
Trying to figure out whether an NFP health care board of directors is effective or ineffective need not be like nailing Jell-O to a tree. What the board actually does can be both seen and quantified. Then it can be compared with known best practices of NFP governance. These ten measures, it is suggested, are the most fundamental of the methodologies available to analyze governance effectiveness and should be tried by every board interested in improving itself and its service on behalf of the public.