



These are exciting and challenging times for board members of not-for-profit health care organizations. The main driver of this state of affairs is a field-wide transformation that promises to result in better quality, higher value, and population health improvement.

Most board members see this as a positive move for their organization and community, since their missions often speak to the need to improve the health of the communities they serve.

In response to this dynamic environment, high-performing boards are ensuring their own governance structures and practices provide appropriate oversight for their changing organizations. They are requesting more frequent education on health trends; finding ways to spend more time in strategic discussions; revisiting their committee structures; and adding board and committee members with new areas of expertise. These are all positive developments.

Common Board Challenges

However, some boards have experienced challenges as they modified their organization and their governance in the new environment. Too often, anxious, well-meaning, but misguided trustees:

- Ask questions about management-level issues (e.g., questioning line items in the budget) due to concern about future financial stability.
- Represent one constituency over others (e.g., physicians protecting their specialty or practice).
- Share confidential information with non-board colleagues (e.g., describing a potentially lucrative real estate transaction).
- Neglect to disclose a potential conflict of interest (e.g., ownership in a business to whom the hospital or system is considering awarding a contract).

Increased External Scrutiny

A complicating factor is the increased attention being paid to boards of all types, but especially to not-for-profit boards. Regulators and legislators have a keen interest in whether non-profit organizations are deserving of their tax-exempt status. For instance, Senator Charles Grassley (R-IA) continues to question executive compensation levels and the Internal Revenue Service (IRS) has added detailed questions to the Form 990 about boards' conflict of interest policies and members' independence. Boards also continue to face scrutiny from the public and media.



New Reality

In the past, not-for-profit boards enjoyed a public presumption of doing good works for unselfish motives. The new reality is that not-for-profit boards must demonstrate transparently that they deserve the public's trust through their community benefits, prudent stewardship, and ethical conduct.

Fiduciary Duty of Oversight

Because of the issues listed above, savvy boards are reviewing their legal, fiduciary duties and conflict of interest requirements. They use a special education session or part of a board retreat to fully discuss these issues and often use mini case studies to help board members understand how to apply the concepts to their board service.

As a reminder, the overarching fiduciary duty is oversight, which entails:

- Developing the mission and helping to formulate strategy;
- Establishing and monitoring adherence to policies, norms, and procedures;
- Carefully selecting a competent CEO;
- Delegating work to the CEO; and
- Monitoring the performance of the organization and CEO.

It is often helpful to point out that “oversight” (or “governance”) is different from “management.” Governance is exercising accountability by setting goals, making major policy and strategy decisions, and *overseeing* (monitoring) implementation. Management is delivering results by *implementing* policy and strategy as set forth by the governing body, managing operations, and reporting on performance. (Note: The trustee who wanted to review each line item in the budget was not providing appropriate oversight; he was acting too much like a manager.)

Board members of all types appreciate learning that they owe their fiduciary duty of oversight to different “entities” in the for-profit and not-for-profit sectors. A board member of a for-profit corporation must be concerned about the shareholders’ interests. Whereas, in the not-for-profit sector, a board member’s legal duty of oversight is due to the Public Trust – a legal concept which essentially means your duty is to ensure the mission of the corporation (as articulated in the Articles of Incorporation) is preserved.

This distinction is especially helpful for new trustees who have previously served on the board of a for-profit corporation and for physicians who are under the (mistaken) impression that they are fiduciaries for the medical staff. Once a board member understands these foundational differences in approach, they are often quickly able to act more appropriately in the boardroom.



Fiduciary Duties of Care, Obedience and Loyalty

The other three fiduciary duties of care, obedience and loyalty describe how the fiduciary duty of oversight is to be carried out. The fiduciary duty of care states that the board must be knowledgeable of all reasonably available information and act with appropriate prudence and care. A simple parallel is the research one would do when buying a new car (e.g., check Consumers Reports; ask “experts”).

The fiduciary duty of obedience states that the board must ensure that the organization is obedient to its central purposes as described in its articles of incorporation and the mission. For instance, board members recognize that legally, they must make decisions based on what is best for the mission, not what is best for any particular stakeholder group.

The fiduciary duty of loyalty requires trustees to discharge their duties unselfishly, to benefit only the corporate enterprise and not the directors personally. This means directors must:

- Refrain from discussing confidential board business with others
- Avoid competition with the organization
- Disclose situations with potential for conflicts

This fiduciary duty is often the most challenging for boards. Some trustees find it difficult to keep information confidential (although, by law, they must).

Another key component of this duty is that a board member should not compete directly with the hospital or system. Too often, physician board members are unaware of this duty, and they think they can serve as a voting member of the hospital board while opening an ambulatory surgery center that would take procedures out of the hospital.

Conflicts of Interest

It is the fiduciary duty of loyalty that is the foundation for concerns about conflicts of interest identification and management. It is important to first acknowledge that potential conflicts of interest exist on all boards; a conflict of interest is not “bad” per se. Conflict of interest management is a matter of law and it can be addressed by clear policies and procedures. Those procedures include:

- Annual disclosure of potential conflicts
- Written policy/process
- Minutes documenting attendance and votes

Unfortunately, not all board members fully understand that, legally, they must disclose all potential conflicts. For instance, a trustee must disclose any ownership in a potentially competing entity or an organization with whom the hospital or system may do business. This



situation can be rectified by a thorough new board member orientation process.

The Board's Liability Protections

The reason that conflicts of interest are important to identify is that the board is protected from liability regarding its decisions if the board:

- Had good faith and a mission orientation
- Was attentive, with reasonable inquiry
- Used common-sense business judgment
- Was disinterested ... ***hence the focus on conflicts of interest***

Independence

An issue that is related to conflicts of interest is that of board member “independence.” A board member is “independent” according to the IRS Form 990 if he or she meets all three of these criteria:

- Not an officer or other employee of the organization or of a related organization;
- Did not receive total compensation or other payments from the organization or related organization exceeding \$10,000 in the tax year; and
- Neither the member, nor any family member of the member, was involved in a transaction with the organization or a related organization that would be reported on the Schedule L.

Physicians are in a unique position regarding the issue of independence because they can be:

- Competitors
- Business partners
- Employees
- Ex-officio board members (e.g., Chief of Staff)

In addition, “independence” of physicians is confusing. They are:

- Not independent according to IRS community benefit / tax exempt status standard;
- May be independent for IRS Form 990 reporting purposes; and
- Not independent for compensation oversight (IRS Code 4958).

Best Practices

Boards that want to improve their approach to conflicts of interest and independence management do the following:



1. Provide education on the IRS’s definitions of “independent.”
2. Determine the board’s definitions and policies.
3. Ensure that *at least the majority* of the full board is “independent.”
4. Change committee charters to include “independence” requirements:
 - a. 100% of Executive Compensation Committee
 - b. 100% of Audit Committee
5. Align recruitment/selection policies and processes with independence definition/policies.
6. Discuss the board’s approach to conflicts of interest (e.g., merely abide by the law, take a middle ground approach or strive to be beyond reproach).
7. Consider creating “disabling guidelines” that state conditions under which an individual cannot be a board member (e.g., owner of a competing organization).
8. Define “actual” and “potential” conflicts of interest.
9. Clarify the individuals who are covered by the policy.
10. Consider non-economic benefits as potential conflicts.
11. Insist on annual *and* episodic disclosure.
12. Create detailed disclosure forms (requiring details such as ownership percentages).
13. Ensure forms are reviewed by “independent” members of the board.
14. Share the completed forms with the full board, so they are aware of potential conflicts.
15. Post information on potential conflicts of interest on the website, to encourage transparency.
16. Create a board culture in which it is easy to invoke the conflict of interest policy and procedures.

Boards that take a proactive approach to understanding their fiduciary duties and managing their conflicts of interest/independence will be better positioned to help navigate their organizations successfully today and into the future.

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