

Ten Best Practices for Measuring the Effectiveness of Nonprofit Healthcare Boards

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While it may not be easy to achieve, effective governance in a for-profit enterprise has the advantage of being 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) company executives are not under indictment for accounting fraud, the board of directors is probably doing its job well. When the legal duty is to look out for the shareholders' interests, then, measurement of effectiveness is relatively simple.¹

In the nonprofit world, on the other hand, and especially in healthcare, effective governance is not as easy to discern or to measure, and it is certainly becoming more difficult to recognize. This paper is directed at those individuals and organizations with an interest in whether a given nonprofit healthcare entity has effective governance. Thus its intended audience includes 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 Healthcare Organizations
- Bond-rating agencies
- Bond counsel
- Bond underwriters
- Bondholders and other major creditors
- Insurers
- The medical staff of a healthcare organization
- Nonphysician 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

All of the above entities should take a similar perspective when seeking to evaluate the board of a given nonprofit healthcare organization, though some will clearly have a more financial focus. It is worth remembering that not everyone defines an optimally effective nonprofit board in the same way. For example, religious sponsors and members of the community may place more emphasis on mission than on bond ratings. Senior managers and medical staff leaders may prefer a board that does not always demand explanations or that delegates more policy making to them. Bond underwriters may prefer boards that do not argue for flexibility in bond covenants so the bonds can be sold more quickly. These examples illustrate that there are both conflicts and dualities of interest between nonprofit boards and many of those with whom they deal. Effective boards find workable ways to ensure that the interests of both the organization and the public are accorded the highest priority in such situations.

This paper is intended to help contribute to the growing literature and work in the field on objective methodologies for evaluating the conduct and effectiveness of the boards of nonprofit organizations.² The premise of the discussion here is that effectiveness can indeed be measured by benchmarking standards of board conduct against consensus best practices. Defining best practices is thus the first step in attempting to measure board effectiveness.

THE TRADITION OF VOLUNTEERISM

American volunteerism, "invented" by Benjamin Franklin in the 1750s and analyzed for its sociopolitical uniqueness by Alexis de Tocqueville in his *Democracy in America* in the 1820s, is the specific mechanism being evaluated when one is measuring the effectiveness of nonprofit boards. Based in American grassroots mores and periodically enhanced (or corrupted) by the varying mix of law and politics in the 50 states, nonprofit organizations today operate 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 state attorneys general and by concerned citizens whose interests are, by definition, nonproprietary.

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 often known

as trustees. Trustees' legal obligations are "fiduciary," that is, owed to others. Because trusts have historically been overseen by courts under the U.S. legal system, 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 misperformed, either negligently (misfeasance) or intentionally (malfeasance), much of the law governing nonprofit corporations is in terms of "thou shalt not..." The two broad legal duties of a nonprofit director are loyalty and care.³ The specifics of these duties all too often emerge from cases involving fiduciaries who were disloyal to or uncaring of the interests of the public. More troublesome is the fact that the law governing fiduciary duty is underdeveloped and often ambiguous. As a result, boards have considerable latitude in making decisions (an example being the business judgment rule), but trustees are subject to judicial second-guessing as to whether the duty of loyalty was fulfilled.

THE NEED FOR GOVERNANCE STANDARDS

The best example of how not to govern a nonprofit organization in the last decade was the Allegheny Health, Education and Research Foundation (AHERF). AHERF filed for Chapter 11 bankruptcy protection in July 1998 after many years as a dominant player in nonprofit healthcare in both the Pittsburgh and Philadelphia markets. Published after-the-fact, analysis⁴ revealed that the CEO and board chair, engaging in clever and deceptive "agenda practice"⁵ over a long period of time, effectively excluded the board and its executive committee from their policy-making roles.

After the bankruptcy filing, this exclusionary pattern of behavior led AHERF board members to invoke the well-known "Sgt. Schultz defense" to excuse their inaction: "I know nothing." True or not, this defense illustrates what is lacking in such boards (often composed, as was the AHERF board, of captains of industry and leading citizens): the personal courage to look a fellow trustee in the eye and ask the tough question. That question may be about a conflict or duality of interest, or whether there are viable alternative courses of action, or whether a given factor was considered appropriately. Courage is required to ask such questions of friends and colleagues on a board, and its absence accounts for significant instances of misfeasance in governance. Fiduciary directors/trustees are clearly not serving on their own behalf, but on behalf of the public. Through the Volunteer Protection Act, federal law provides that volunteers working for nonprofit organizations who are being paid less than \$500 per year are immune from personal liability for actions taken in good faith; most states have similar laws for volunteer directors/trustees/officers of nonprofit organizations. The important question, however, is what "good faith" means.

It is likely but a matter of time before a court with the right set of facts concludes that a defense of "I know nothing" is inconsistent with a fiduciary's duties, and that the know-nothing trustee is not acting in good faith.⁶ CEOs and board members should therefore anticipate such scrutiny and protect themselves and the institution from liability. The need to do so will be (or has been) anticipated by directors' and officers' liability insurance carriers, which will bear the initial brunt of any such development.

TEN BEST PRACTICES FOR NONPROFIT HEALTHCARE BOARDS

Outlined below are ten best practices in nonprofit governance, each of which can be measured by boards, first to assess the degree to which they judge the board is performing well against each best practice, and second to define practical actions to enhance their performance. These practices have nothing to do with the average net worth of the board members and little or no correlation with the organization's debt-to-equity ratio. They apply equally to large academic medical centers and to small community hospitals. These practices can be used to assess whether nonprofit healthcare boards are operating in a manner that can withstand scrutiny of the effectiveness with which they are fulfilling their fiduciary responsibilities.

Additional study and research are necessary to justify any broader assertions—for example, that compliance with these best practices will produce a financially sound organization. Research will also be required to develop and test objective measures of performance in these areas. What can be said now is that boards that adhere to these best practices are continually becoming more effective as volunteer policymakers and will ultimately establish a documented record of their efforts to fulfill their fiduciary duties. To the extent that their effectiveness results in group confidence and fewer instances of negligence in decision making, the organization, the public it serves, and the directors/trustees all benefit.

1. Adherence to Legal Requirements

The most fundamental measure for evaluating a nonprofit board is whether it adheres to express requirements of law (judicial, legislative, or regulatory) as to what the organization and the board should and should not do. In general, compliance with these requirements can be measured by examining the exercise of "due diligence"—a businesslike process for learning what is necessary before making decisions, such as using the right checklists and interview techniques to gather information.

The average member of a nonprofit board cannot afford to commission a comprehensive due diligence review of the organization's operations. Those who rate or issue bonds perform such reviews routinely; usually, however, the hospital or health system pays for the review. 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 unusual transactions, the board or one of its committees should be involved in framing the due diligence questions posed during the review.⁷

This unique opportunity is usually wasted entirely as a board education method unless a substantial problem surfaces that must be discussed with the board's finance or audit committee. Indeed, there are other outsiders who look routinely at healthcare organizations to evaluate whether they are following applicable laws. These include licensure authorities, accreditation agencies, certification organizations, insurers, and law enforcement authorities pursuing complaints or allegations. Some of these reviews are recurring and routine; others are episodic and non-routine. All produce written reports to which the institution usually has an obligation to respond in writing, generally 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 of these reviews and reports should be assigned to an appropriate board committee, with conclusions and issues being shared with the full board. This is not micromanagement by the board; it is a combination of senior management evaluation, fulfillment of fiduciary duties, and basic due diligence. Being duly diligent about the status of one's organization is the first requirement for responsible governance, and board monitoring of such third-party evaluations is easily measurable if it exists.

2. Corporate Compliance Mentality

Determining that someone is either not doing something that is proper or actually concealing improper behavior may be difficult. In the end, however, these are the very questions conscientious board members need to ask—of the hospital's senior management, of its medical staff, and of each other.

The concept of corporate compliance was developed for this purpose. Known within for-profit corporate America for many years, corporate compliance is a process of honest self-scrutiny, often involving objective third-party evaluators in a relationship of attorney-client privilege,⁸ so that an organization finds out about its legal deficiencies from an objective "friend" rather than a prosecutor or the news media. When done properly, such an evaluation produces a confidential report that the board of directors or an appropriate board committee can study in depth; the board can then monitor steps taken in response to the report.

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 follow from

a compliance mentality. Establishing such a mentality signals to all employees that the board takes its fiduciary duties seriously and will not tolerate shortcuts to maintaining a high-quality organization. An established compliance mentality is a strong statement to patients, physicians, accreditors, and regulators about how the organization is governed. A well-developed compliance program results in measurable legal risk management and constitutes another best practice of good governance. One mechanism for achieving a compliance mentality is for the board to establish an internal compliance auditing committee.

3. Governance Competency Development

Nothing is as certain in healthcare as change. The hospital trustee who began serving in the 1990s, even if well oriented upon assuming office, must constantly be educated as to the board's duties and the newest challenges in the healthcare industry. Great boards also develop a board member talent profile that not only describes the other jobs and community relationships that could be of value to the hospital, but also provides a candid indication of the competencies (knowledge, skills, and attitudes) individuals bring to the board's work and the competencies that need to be developed to optimize each individual's value to the organization's governance.

This drive for competency-based governance can be developed at board meetings, at retreats, at committee meetings, through regular publications and special announcements, and through attendance at recognized seminars on healthcare issues; then, board members need to receive continuing governance education and development, just as clinicians and managers need continuing education in their fields. Since directors generally are not paid to do their jobs, the time and effort required to carry out governance development often poses a challenge.

It is important to keep in mind that overly deferential conduct is 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 cannot be a master of everything, everyone can and should be the master of the tough policy question.

The board that continually develops its competencies is engaging in another measurable best practice. The board chair, the CEO, and the governance committee chair should together take the lead in ensuring meaningful education for the entire board and not just its new members. Governance education and development thus need to be made easily available and

routine. Members of a well-balanced board will also, of course, learn from each other as they perform their board service; therefore, a director returning from an educational event should share his or her learning and materials with the rest of the board. Every board, and each board member, should have a formal and informal governance education and development calendar for each year, supplemented by having individual board members lead discussions after attending educational events. Participation in competency development activities is an easily measurable activity that pays immediate dividends.

4. Use of Performance Dashboards

Great boards develop and nurture a “culture of performance” in which the work of the board, the CEO, and the executive team are all aligned and incented to drive toward the successful accomplishment of the organization’s strategic mission and plan. The performance orientation brings with it a call for enhanced performance monitoring and “strategic conversations” about progress to plan and how best to embrace alternate strategies to get back on track.

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 information in digestible form. Offering lengthy and complex textual descriptions of proposed actions is a well-known obfuscation technique, designed to ensure that objections will be difficult to articulate. Such obfuscation may be the result of management negligence rather than intentional tactics; nonetheless, neither is acceptable or effective governance.

Dashboards are a way to present information to a board in a clear and concise form. Dashboards are graphics that display comparative performance indicators, allowing the board to see at a glance the progress (or lack thereof) made on those issues the board has decided should be the organization’s priorities. Dashboards can also be used to compare a hospital 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 against acknowledged industry benchmarks, as long as the best-known performance can be obtained for a truly comparable unit. Indeed, assisting the board in obtaining the right benchmarks for comparison is a role of good management.

With color coding, dashboards can clearly display both excellent performance and deficiencies. For example, yellow could be used to represent more than 3 percent over objectives, red a deficiency of greater than 3 percent, and green performance within 3 percent of objectives in either direction, enabling board members to see quickly what areas ought to be 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 dashboards because they are easiest to display. But effective boards do not limit themselves to that which is easy. With the Medicare program and consumers now attempting to measure quality at every hospital, boards cannot overlook the value of having such data available, both comparatively and by trend line. Quality counts, and whatever counts should be communicated in dashboard form.

As performance changes for the organization (in the right direction), educated boards will adopt new priorities to be displayed on the dashboard. Doing so will also permit the board to log into the “accomplished” category those issues for which the dashboard has shown material progress. This is an 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. The board will also need to discuss what benchmarks to use and with what competitors or universes the institution should be compared. Boards that master this process are the most effective in carrying out their responsibilities.

Two additional points should be made about the value of dashboards. First, 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, and not just concentrate on past performance. Dashboards help boards visualize that there is or can be a direct impact on performance from their policy decisions. Absent such a realization, boards’ ventures into new programs or directions are based more on faith than on the confidence that they can make the venture work.

Finally, it must be emphasized that the use of dashboards is not micromanagement by the board members. Rather, it is the essence of meeting the board’s legal responsibility for overseeing how the organization is run.⁹ It is a methodology for identifying and measuring those priority objectives established by the organization’s policy makers. It is also an acknowledged way for governance to show that 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 confidence in governance and will clearly distinguish boards that use this best practice from those that do not.

5. Board Agenda Management

Best governance practices need not all be difficult to achieve. Some can be relatively mundane, but they are no less essential to the self-scrutiny process or to the transparency and accountability concerns of external evaluators, such as those involved in the issuance of hospital bonds or the granting of accreditation. One example, often overlooked and underestimated, is what might be termed “board agenda management,”

a concept that encompasses the following:

- A clear agenda for board meetings, with estimated time allocations
- Web-based availability (24/7) of board materials with easy access and review
- Clear supporting materials, including alternatives
- Executive summaries for complex issues
- Pre-drafted board resolutions
- “Consent agenda” to expedite handling of routine items, including regular committee reports
- Declarations of conflicts and dualities of interest 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 by the board of its own effectiveness
- 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 overuse) of video and audio meetings by some or all participants, to enhance attendance and decrease travel time for regional or national boards
- Programmed disclosure to the entire board of all Internal Revenue Service (IRS) Form 990 information (open to the public)
- Some form of continuing governance education and development, however brief, at each board meeting
- Use of guest speakers at meals to utilize “down time”
- Clear identification of executive session minutes, separate from regular minutes
- Parliamentary procedure at board meetings that encourages questions, seeks balanced presentations, and respects all good-faith questions, but fairly limits redundant and irrelevant discussion

There are specific methods for measuring whether a given board's agenda practice is at the best-practice level. Similarly, those evaluating due diligence can utilize these methods for risk management purposes. Since these techniques are means of avoiding board members' use of the “I know nothing” defense, they should be studied and adopted as measures to ensure board effectiveness.

6. Avoidance of Conflicts and Dualities of Interest

If board members keep in mind three simple rules regarding conflicts and dualities of interest, they will generally want to do

the right thing about such conflicts:

- Undisclosed conflicts are, by definition, not “in good faith.” Lack of disclosure has the legal effect of nullifying all the director's statutory immunities.
- Undisclosed conflicts can result in substantial federal excise taxes on affected individuals who are corporate “insiders” and who obtain “excess benefits” from their organizations.
- An apparent conflict can be almost as much of a problem as a real one in terms of public embarrassment for individuals and nonprofit boards.

It is no accident that in recent years, conflicts of interest among nonprofit insiders have led to substantial litigation, embarrassment, and statutory reform for nonprofit boards. Every external agency—public and private—having authority over nonprofit organizations has expressed concern about the effects of conflicts and dualities of interest, especially in healthcare. These agencies include the 50 secretaries of state, the 50 attorneys general, the IRS, accrediting agencies, licensing agencies, bonding or lending agencies, and contracting organizations.

In addition, elements within nonprofit healthcare 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 and dualities of interest occur, but that these conflicts can be identified, discussed, and dealt with appropriately so the organization is not disadvantaged. Doing so requires that clear policies regarding conflicts be adopted, that relevant procedures be in place, and that these procedures be enforced consistently:

- The board should adopt a written policy on conflicts and dualities of interest that is enforced and requires written periodic disclosures. All of those present at each board meeting should be reminded of this policy.
- A procedure should be instituted for identifying all insiders (“disqualified persons”) under Internal Revenue Code (IRC) § 4958 and establishing for every contract with each of these individuals a “rebuttable presumption of reasonableness” under the IRS regulations.
- A governance committee of the board (see the next section) should oversee the process for disclosure and resolution of conflicts and recommend board actions to deal with problematic situations.

The existence and use of each of these three mechanisms can easily be verified. Agenda practice, including good minutes, is part of the conflict prevention and resolution process and provides evidence of compliance. In addition, boards should keep track in their records of how specific issues involving conflicts or dualities of interest or alleged breaches of other fiduciary duties were

resolved and why. Given constant board member turnover, institutional memory of governance matters is tenuous unless steps are taken to retain such knowledge. Retention of information on fiduciary decisions will provide guidance over time on how best to resolve difficult governance challenges in the future. It will also provide a governance education and development opportunity with regard to fulfilling the board's fiduciary responsibilities.

7. Non-episodic Corporate Governance Effectiveness Committee

In many nonprofit organizations, the annual report of the board nominating committee is the only written evidence of deliberations regarding enhancement of the board and how it is functioning. Yet being able to measure improvement in governance requires attention to nominations and many other closely related activities as more than a finite annual episode. This need has led to the creation of board governance committees that meet regularly throughout the year and deal with such matters as the following:

- Director/trustee/officer nominations
- Preparation of a running chart of potential board members, specifying the skills brought to the table by each
- Preparation of prioritized recommendations for skill sets needed by the board as it goes forward
- Review of all disclosures of conflicts and dualities of interest and recommendations to the board when special action is required, along with a review of all documentation of IRC § 4958 transactions
- Annual review of corporate bylaws and procedural policies affecting governance for sufficiency and consistency, and development of recommendations for modifications
- Preparation of recommendations for orientation of new directors and all for continuing governance education and development, both at board meetings and through special events, including board retreats
- Preparation of recommendations for the board's evaluation of its effectiveness and that of its meetings
- Review of the results of these evaluations
- Review of the effectiveness of structural relationships with controlled/majority-owned affiliates with regard to the use of reserved powers
- Review of all due diligence reports affecting or evaluating board effectiveness
- Preparation of recommendations annually on changes to be made to dashboard performance indicators (may also be assigned to the executive committee)
- Review and preparation of recommendations on any 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 viewed as an internal assessment entity that regularly handles important matters that can easily fall between the cracks. The intent is to make non-episodic that which is usually disjointed and episodic (performed 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 ensure board effectiveness.

8. Voluntary Sarbanes-Oxley Compliance

With the exception of whistleblower protection, the landmark Sarbanes-Oxley Act (SOA), hurriedly enacted by Congress for publicly held corporations to deal with the post-Enron world, does not apply to nonprofit organizations. To the extent that the public is being protected from the relatively unscrutinized conduct of corporate insiders of entities imbued with a public interest, however, the SOA rationale clearly applies to nonprofits. The SOA touchstone is the independence of governance decision making, as opposed to decisions made to line someone's pockets—the very objective of IRC § 4958, IRC § 501(c)(3), the Stark Law, and the Medicare Anti-kickback Law.

Setting aside statutory mandates to the Securities and Exchange Commission 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 (e.g., directors, board committees, attorneys, auditors) to disclose inappropriate relationships or to sanction those who do not make such disclosure (e.g., through loss of compensation, disqualification to serve or to practice). Eliminating the ability of some individuals to control information in secret enhances the independence of advice and of governance decision making. The effective nonprofit board, perhaps through its governance committee (described above), should study which of the SOA methods for scrutiny might warrant being adopted voluntarily. These methods include such measures 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 must be restated. This is not to suggest that nonprofit healthcare providers should adopt all SOA mandates. But voluntary adoption of appropriate and fundamental SOA procedural mandates can easily be measured and is an especially timely means of evaluating board effectiveness.

9. CEO and Management Competency Development

CEOs and their boards are becoming increasingly aware of the importance of succession planning and talent management;

however, in Ram Charan's recent article on "the succession crisis," he describes how many boards are unprepared to play either a fiduciary or a catalytic role in succession planning at the senior executive level. Especially important to the long-term vitality of the enterprise is the board's attention not just to a well-planned and implemented CEO performance review, but the use of this review for the establishment of a competency development plan for the CEO, as well as the development and periodic updating of a clear succession plan for the CEO and the executive team.

As described in NCHL's white paper, *Best Practices in Health Leadership Talent Management & Succession Planning*, "best practice boards are organizing themselves for increased involvement in succession planning and are devoting increased time to the task. In many best-practice organizations, the board's traditional compensation committees are being refashioned as compensation and leadership development committees with primary responsibility for succession planning within the board. Succession planning discussions are conducted regularly, even when no apparent executive transition is forthcoming."

Extensive research by the National Center for Healthcare Leadership has defined that one of the central roles of great boards is the development of a culture that supports the sustained development of the CEO and senior leadership team's capabilities using an integrated leadership development system to achieve high performance. Using a foundation for its work with leading health systems across the U.S., NCHL's Health Leadership Competency Model consists of 26 competencies that have been identified for great healthcare leaders. It is toward these competencies that boards should continuously assess their practices for reviewing, developing, and incentivizing the CEO and the executive team.

Ironically, that which should be the highest priority on an annual basis for the nonprofit 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 usually are unwilling to admit that it is being done poorly. Particularly in those organizations in which the CEO has served many years and/or has acquired a strongly positive reputation, volunteers whose tenure may be much shorter may not understand that their duty includes critiquing an individual who has come to personify the institution.

Because the details of the CEO evaluation must be kept private, this measure of board effectiveness may be the most sensitive of all those reviewed here. Yet nothing about the process or its outcome is so sensitive that it should be ignored or that its degree of effectiveness should not be measured. Experience shows that:

- CEO and executive team evaluation is best coordinated through a board committee (usually the executive compensation or executive committee).
- All members of the board should be invited to participate in an annual evaluation survey shortly after the end of the fiscal year.
- The evaluation should relate to board-established objectives for that year.
- There should be an opportunity for comments that are open-ended, as well as those responsive to specific questions.
- Either a year-end bonus or any base compensation increase for the next year, or both, should depend on the performance evaluation.
- The effective board communicates promptly, as well as comprehensively, when it evaluates its CEO and senior executive team.
- The process should not be considered final without the CEO's self-evaluation and reaction to the board's evaluation.

Unusual circumstances sometimes call for unusual evaluation techniques. The board chair should always be willing and ready to justify any such techniques thought necessary or desirable by the board or its delegated committee.

Certainly it will be possible to determine whether the above-listed recommendations for the CEO and management evaluation process occurred. Thus the measurement of board effectiveness on this best practice will be almost entirely process driven. Also capable of measurement (and highly important) is the issue of when the evaluation process was completed. If the organization has a calendar fiscal year but the evaluation process takes place in July, it is questionable whether the evaluation can have much effect on conduct in the five remaining months of the year.

10. Board Strategic Planning and Evaluation

This best practice has two components: (1) measurement of the quantity and quality of the board's involvement in corporate planning for the future, and (2) the board's evaluation of its own governance performance. These components are combined because each of the foregoing nine best practices includes some form of planning for the institution, but by nature, no single one of them really asks whether the full board is invested in helping to plan the overall future of the organization.

In the board's self-analysis of whether it is doing a good job, both the immediate past and the future need to be addressed. Whenever the board engages in self-scrutiny the horizon ahead, not behind, is the important one with regard to both the board's effectiveness and the likelihood of future progress for the organization.

Board self-analysis should include what members think about (1) their collective implementation of the foregoing nine best practices in the last year; (2) their collective mindset on the organization's prospects for the future; and (3) their individual views on what each has done or not done for the organization, including any misgivings and commitments for personal performance enhancement. In addition to responding to short-answer questions, each member 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 directions.

Not to be confused with the board's annual self-analysis and its measures of effectiveness (usually occurring after year's end and after the annual board planning retreat) is an important second element of measurable board self-scrutiny—the "single-meeting evaluation." The clear trend in healthcare board meetings is toward fewer, but better, meetings of the full board. Another trend is toward longer meetings, so as to accomplish more and accommodate more governance education and development. It is valuable to give senior management, board leadership, ex officio participants, and newer directors/trustees a single-page questionnaire on the effectiveness of each meeting. The chair and the CEO cannot afford to wait a year to learn that a significant number of the board members are unhappy with the way meetings are conducted, planned, or structured. This practice also permits evaluation of the style and effectiveness of guest speakers, materials, and even meals and other arrangements. Correction of any deficiencies represents a clear step toward greater effectiveness.

NEXT STEPS

Two interrelated follow-up items should be addressed. First is a call for enhanced investment into modern leadership development for our nation's hospital and healthcare organizations. This commitment to leadership development must focus on the executive team and nurse and physician leaders, as well as the board. Indeed, it is the board that must set the tone for an organization-wide culture that drives toward high performance for patient-centered care, focused on achieving the Institute of Medicine's six aims for quality care and based on the unique values and heritage of organization and market.

For the board's leadership development, it must develop a strategy for monitoring and assessing the implementation of the ten best practices identified in this paper. The board self-assessment (see Appendix) can be used as a first draft for review and refinement by CEOs and Board Governance Effectiveness Committees.

Second, there is a growing need to develop, test, and continuously refine performance standards for nonprofit governance as applied to board members' fiduciary duties and strategic

oversight responsibilities. As noted earlier, the law in this area is intended to provide an accountability roadmap for governance decisions, but often does not because of the inadequate development of legal doctrine.

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

CONCLUSION

The effectiveness of the board of a nonprofit healthcare organization can be measured and will increasingly be expected to be measured vigorously by external stakeholders. What the board actually does can be both observed and quantified, and then compared with known best practices of nonprofit governance. The ten best practices reviewed in this paper represent the most fundamental measures available for analyzing the effectiveness of governance, and should be implemented by every board interested in improving itself and its service on behalf of the public.

ENDNOTES

- 1 This has not necessarily always been true, but should be now given the legal reforms described below. Until 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.
- 2 See the bibliography for information of The Governance Institute, BoardSource, The Health Research and Educational Trust, the American Hospital Association's Center for Healthcare Governance, and McKinsey.
- 3 Some commentators cite obedience to state corporate purposes as a third fundamental duty.
- 4 L. Edward Bryant, *What Boards Can Learn from the Allegheny Bankruptcy: The Legal Responsibilities of Nonprofit Organizations, Boards, and Executive Officers*, The Governance Institute, Summer 1999.
- 5 See Best Practice #5. Board Agenda Management.
- 6 Arguably, the recent criminal convictions of executives of WorldCom and Tyco indicate that the know-nothing defense is also a losing strategy in the for-profit world.
- 7 This is not to suggest that nonprofit board members replace those who are trained to examine the financial or legal aspects of a transaction. However, those responsible for governance of a nonprofit organization need to ask "What could go wrong?" as well as "How does this organization come out ahead?"
- 8 The privilege will be assertable only 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."
- 9 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.
- 10 This is a parliamentary concept that allows the aggregation of multiple, relatively non-controversial matters under one motion that is not debated. The key to making it work is that any one director, without stating a reason, can ask to remove any item and make it subject to debate. Essentially, the consent agenda items are unanimous consent items.

- 11 It is essential for governance to enforce its rules and policies fairly and consistently. Failure to do so may impede appropriate board decisions. Board chairs should be nominated in part based on this attitude toward open discussion of policy issues.
- 12 L. Edward Bryant, 1999.
- 13 Inconsistent enforcement of policies aimed at ensuring corporate integrity would itself be a serious corporate compliance problem.
- 14 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 the policy.
- 15 Such a legal presumption could be overturned only by evidence of fraudulent or otherwise criminal intent, an extremely difficult burden for the IRS.
- 16 The authors have deliberately not suggested that diversity in board makeup and specific term limits are always among the best practices of measuring governance effectiveness. That judgment will vary by organization. Neither characteristic (i.e., degree of diversity or presence/absence of term limits) will preclude having an effective board, although in some cases more diversity and set terms will assist in leadership improvement.
- 17 The Panel on the Nonprofit Sector issued a 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, p.6. Responsible nonprofit boards will need to study these proposals closely.
- 18 Witt/Kieffer. *Putting Succession Planning in Play: Identifying and Developing the Healthcare Organization's Successors*. Oak Brook, IL: Witt/Kieffer, 2004.
- 19 Charan, R. "Ending the CEO Succession Crisis," Harvard Business Review, OnPoint Enhanced Edition, February 2005.
- 20 See <http://www.nchl.org/ns/documents/CompetencyModel-short.pdf>.
- 21 The entire board should also be advised as to the CEO's annual compensation; if it is on the IRS Form 990, it will be public, and board members do not like to be surprised by having someone else ask them about something they should know.
- 22 S. Kaput, 2005, "Expanding the Scope of Fiduciary Duties to Fill a Gap in the Law: The Role of Nonprofit Hospital Directors to Ensure Patient Safety," *Journal of Health Law*; 38:95-119.

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APPENDIX: NONPROFIT BOARD SELF-EVALUATION OF EFFECTIVENESS

Meeting Legal Requirements

1. Most nonprofit healthcare organizations are the subject from time to time of due diligence reports, compliance surveys by licensure, accreditation and/or certification agencies, and external or internal legal or operational audits. Does this board, either directly or through its

committees, require that all of the findings of all such reports be shared with governance?

2. Does this board, either directly or through its committees, require that management's written responses to all such reports be shared with governance?
3. Does this board, either directly or through its committees, require that the outcomes of all such reports be part of the evaluation of performance and the setting of compensation of the organization's CEO?

Compliance Mentality

4. Most nonprofit healthcare or related corporations have several well-known legal regulatory standards with which they must always, and not just episodically, be in full compliance with the laws. Does this board, either directly or through its committees, require a formal, written program of corporate compliance for the organization in order to submit the organization's operations periodically to honest internal self-scrutiny in those areas of the highest legal or regulatory risk and/or of the greatest possible embarrassment for the organization?
5. Does this board, either directly or through its committees, require that such persons as the corporate compliance officer, the chief privacy officer, the internal auditor and/or legal counsel have direct access to board leadership if necessary, in the judgment of those persons?
6. Does this board, either directly or through its committees, require that it receive regular reports on all self-scrutiny efforts by the corporate compliance officer?
7. Does this board, either directly or through its committees, require that the organization protect so-called "whistleblowers" adequately and communicate that policy to all employees clearly?
8. Does this board, either directly or through its committees, require the declaration and encouragement of a corporate compliance mentality within the organization so that non-compliance issues are more likely to be identified and remedied within the organization than by outside authorities?

Governance Competency Development

9. Most nonprofit healthcare boards present or arrange for the presentation of educational sessions for new and for ongoing board members in order to stay abreast of developments in the healthcare industry and/or professions. Does this board orient its new directors on (a) the history of the organization, (b) the legal duties of board members as fiduciaries, and (c) the current key issues affecting nonprofit healthcare?
10. Does this board sponsor or encourage continuing governance education and development on both

governance and healthcare issues for all members of the board in addition to new director orientation?

11. Does this board subscribe to publications for or otherwise circulate newsletters or other written or online materials on governance and healthcare issues to all board members?
12. Does this board, either directly or through its committees, present some form of education and development, however brief, at all or most of its meetings?
13. Does this board require that those directors who attend outside education and development programs share at least the highlights and lessons of such programs with the entire board in order to maximize both the expenditure and the learning opportunities?
14. Does this board, either directly or through its committees, allow director/trustee input into the subject matter of the board's education and development calendar and program planning?
15. Does this board, either directly or through its committees, regularly utilize senior management, members of a medical staff or faculty, or other in-house experts either for education and development or for backgrounding on policy decisions before the board?

Use of Performance Dashboards

16. Many boards regularly mandate through the CEO the use on a monthly or quarterly basis of graphic performance indicators, also known as "dashboards," to portray data in a more easily understood format and to show data trends more clearly. Does this board ask for or receive regular dashboard analyses in an easy-to-understand form?
17. Does this board require the regular use of dashboards on issues other than financial ones?
18. Does this board review metrics covering multiple aspects of the organization's performance, e.g., operations (cost & quality), finance, human resources (including physician resources), and market and customer relations?
19. The Institute of Medicine (IOM) has called for health system boards to drive their strategic plans toward a care system with six aims. To what extent are these aims individually measured and reported to the board:
 - a. Safe
 - b. Effective
 - c. Patient-Centered
 - d. Timely
 - e. Efficient
 - f. Equitable
20. Does this board hold the leadership accountable for the culture of patient safety in the organization?
21. Does this board, either directly or through its committees, mandate changes in dashboard criteria from time to time

as priorities change for the organization?

22. Does this board, either directly or through its committees, require the utilization of dashboard indicators as part of the CEO's performance evaluation and senior management's compensation in general?
23. Does this board require that the supporting data behind dashboard reports be either distributed with the dashboards or readily available for more specific questions of board members?
24. Does this board, either directly or through its committees, require the use of dashboards in a way which contributes materially to its ability both to set corporate policy and avoid getting too involved in day-to-day management decisions?

Board Agenda Management

25. Most nonprofit healthcare boards have an agenda practice that attempts to help achieve discernible governance objectives. Does this board require clear agendas with estimated allocation of time to each agenda item?
26. Does this board require and note on its agendas that applicable or possible conflicts and dualities of interest for each board meeting be disclosed at each meeting?
27. Does this board require circulation of meeting materials sufficiently in advance of each board meeting?
28. Does this board require draft board resolutions to be circulated with board meeting materials before each meeting?
29. Does this board require senior management and/or consultants participating in proposing board action to present and evaluate alternative courses of action with each major issue under consideration?
30. Does this board require that written executive summaries be prepared and presented with each complex matter placed before the board?
31. Does this board require an executive session at each board meeting in which no paid insiders are present except by invitation?
32. Does this board require the appropriate use of either video or audio conferencing equipment to accommodate directors/trustees who have busy schedules or for special or emergency meetings of the board?
33. Does this board require disclosure to it in advance of all IRS Form 990 information (including highly paid employees, officers and contractors) so each board member will be aware of what is being paid out before the public is?

34. Does this board regularly require the use of a "consent agenda" to save time on routine agenda items?
35. Does this board require concise board minutes, easily scanned for each board meeting?
36. Does this board require clear identification of all materials coming before it which are privileged under an attorney-client privilege, HIPAA, or any other applicable privilege?
37. Does this board require the use of Robert's Rules of Order or some similar accepted rules of parliamentary procedure for board meetings, which rules are in fact followed?
38. Does this board have a tradition or culture that encourages all directors/trustees to speak on important issues and receives their opinions respectfully as part of a mature, deliberative decision-making process?

Conflicts and Dualities of Interest

39. The Internal Revenue Service requires that all Section 501(c)(3) exempt organizations have a written policy on conflicts of interest, preferably located in a corporate organizational document. Does this board require at least the annual written disclosure of all actual and potential conflicts of interest by each officer and director?
40. Does this board also require the disclosure in writing of material dualities, i.e., fiduciary obligations to competing nonprofit organizations?
41. Does this board's conflicts/dualities policy require disclosures whenever they occur and not just annually?
42. Does this board's conflicts/dualities policy or practice require that disclosures are appropriate when applicable at each meeting of the board or its committees?
43. Does this board's conflicts/dualities policy extend to all transactions with "disqualified persons" under the excess benefits excise tax provisions of Internal Revenue Code Section 4958?
44. Does this board's conflicts/dualities policy require that all transactions with "disqualified persons" be structured so as to establish a rebuttable presumption of reasonableness under Internal Revenue Code rules?
45. Does this board's conflicts/dualities policy require that all disclosed conflicts and/or dualities of interest be disclosed to the entire board and not just to the chair, the CEO, and/or legal counsel?
46. Does this board's conflicts/dualities policy require that someone in the governance structure make a determination that a disclosed conflict or duality requires no further action?
47. Does this board's conflicts/dualities policy require as well that directors/trustees shall not release "business opportunity" confidential information to outsiders?

48. Does this board's education and development include legal orientation to the effect that undisclosed conflicts of interest can preclude a finding of a board member's acting "in good faith?"
49. Does this board require that prospective directors/trustees first be screened or questioned as to actual or potential conflicts or dualities of interest before being formally invited to stand for election to the board?

Effectiveness Committee

50. Does this board require that its bylaws and other important governance policies be reviewed periodically for recommendations regarding enhancement?
51. Many nonprofit healthcare boards are starting to treat concerns about the effectiveness of governance on a continuous basis and not just when a nominating committee is convened before the annual meeting. Does this board require through its bylaws that some board committee be charged with analyzing and enhancing governance on a comprehensive and non-episodic basis?
52. Does this board, either directly or through its committee, have a plan for what skill sets are or may be needed on the board and for proposing, considering, and evaluating possible board nominees throughout the year?
53. Does this board require that certain board committees, where lawful, consist in part of persons other than voting directors as a practical means of evaluating potential nominees for board positions?
54. Does this board, either directly or through its committees, require that complete attendance records be kept for each director/trustee as to board and committee meetings?
55. Does this board require that regular reports be made, by minutes or otherwise, to the full board on the activities and recommendations of the board committee(s) responsible for governance analysis and enhancements?

Voluntary Sarbanes-Oxley Compliance

56. Many nonprofit healthcare boards of directors/trustees, in the belief that the rationale of the Sarbanes-Oxley Act ("SOA") should also apply to nonprofit organizations, are voluntarily adopting various aspects of SOA or willingly entering into contracts with outside parties (such as bond rating agencies), which will require specified SOA compliance. Does this board require that the members of the board are educated on the scope of and possible application to them of the tenets of SOA?
57. Does this board have a board audit committee that (a) requires the inclusion of at least one financial expert, (b) excludes all members of senior management as

voting members, and (c) independently meets with and recommends hiring/retention of the organization's auditing firm?

58. Does this board, either directly or through its committees, require that the organization's financial statements be certified annually by both the CEO and CFO?
59. Does this board require that all incentive compensation for the CEO and CFO is forfeited in any year in which the organization's financial statements have to be restated?
60. Does this board, either directly or through its committees, evaluate, either previously or on an ongoing basis, which of the SOA regulatory standards should be voluntarily adopted by the organization?

CEO and Management Competency Development

61. Is the organization actively engaged in an integrated approach to leadership development?
62. Do the governing board education programs address leadership development and succession planning?
63. Does this board hold senior management accountable for leadership development, for all levels and disciplines, in the organization?
64. Is there adequate budgetary support from your board to achieve your organization's leadership development goals?
65. Does this organization provide succession planning for medical leadership, nursing leadership, and administration of the organization?
66. Many nonprofit healthcare boards of directors/trustees are adopting fairly formal methodologies for the annual board evaluation of the organization's CEO. Does this board have in place a CEO evaluation process that fairly looks at all relevant factors and allows input from each director?
67. Does this board, either directly or through its committees, mandate a list of clear organizational goals or objectives each year for the CEO and communicate them to the CEO and the board in a timely fashion?
68. Does this board, either directly or through its committees, require a process by which the CEO is told clearly each year in a timely fashion how well the CEO performed against the established goals and objectives for the prior year?
69. Does this board, either directly or through its committees, require the CEO each year to do a written self-evaluation and to react to the board's evaluation of the CEO?

70. Does this board, either directly or through its committees, require at least periodic discussion and analysis, with material input from the CEO, on senior management succession planning for the organization?

Board Strategic Planning and Evaluation

71. Most nonprofit healthcare boards of directors/trustees insist on board involvement in the organization's planning for new facilities, significant financial transactions, and strategic directioning. Does this board, either directly or through its committees, participate meaningfully in organizational planning for the long term?
72. Does this board, either directly or through its committees, spend as much time and effort talking about the future as it does discussing what has already happened?
73. Does this board believe that the organization's planning and plan implementation efforts will have more positive impact on the organization than non-controllable, external forces?
74. Does this board require attendance at a planning retreat each year for the board to be able to study intensively those issues which are of importance to the organization's future?
75. Does this board, either directly or through its committees, evaluate its own performance in some way for each board meeting and each board retreat, so that it does not become necessary to wait until the end of a year to identify desired procedural change?
76. Does this board schedule contextual events (group meals, entertainment, receptions, golf outings, and other "extra-curricular" activities) designed to enable the directors/trustees to get to know each other better and trust each other more?
77. Does this board, either directly or through its committees, require an annual evaluation by the board of its effectiveness as a board, the results of which are reviewed by the entire board?
78. Please comment below on: (a) The methodology of this survey instrument, or (b) other aspects of this board's governance techniques in need of change or which are remarkable.
79. Does this board, either directly or through its committees, provide an opportunity for each board member to evaluate the effectiveness of his/her participation on the board and in its deliberations and decision-making.