Healthcare Board of Directors:
Meeting Governance and Compliance Challenges
Minimizing Breach of Fiduciary Duty Risks Amid Heightened Government Scrutiny

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Healthcare Board of Directors: Meeting New Governance and Compliance Challenges

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May 17, 2012
Agenda

- Recent Governance Developments (Mike)  25 Minutes
- Indicators of Board Ineffectiveness  (Paul)  12 Minutes
- Governance & Compliance Best Practices  (John)  25 Minutes
- Applicability of New CMS Rules  (Paul)  5 Minutes
- The Future of Board Governance  (Paul)  10 Minutes
Recent Governance Developments Impacting Healthcare Boards
Recent Developments

- IRS Scrutiny and Reform Initiatives
- Patient Protection and Affordable Care Act
- State Scrutiny and Reform Initiatives
- *Lifespan Corp. v. NEMC*
- *In re Lemington Home for the Aged*
IRS Scrutiny and Reform Initiatives

- The New Form 990 and Governance
- Updated FAQs on Governance
- Updates to the 2011 Form 990’s Governance Questions
- Guide Sheet and Check Sheet
- Lois Lerner’s April 19, 2012 Speech
IRS Scrutiny and Reform Initiatives

The New Form 990 and Governance

- Part VI of the Form
  - Governance: Director Independence and Key Definitions from the Instructions; Family and Business Relationships
  - Policies: Conflict of Interest, Whistleblower, Doc. Retention, JVs
  - Disclosure: IRS Forms, Governance Documents, Financial Statements

- Many Other Parts and Schedules with Governance Implications
IRS Scrutiny and Reform Initiatives

IRS’s Frequently Asked Questions on Governance Section

Updated June 27, 2011

- FAQ #4 – Committee versus Board
- FAQ #8 – Reasonable Effort
- FAQ #10 – Related Organizations
- FAQ #11 – Parent Organization’s Policies
Updates to the 2011 Form 990’s Governance Questions

- Governing Body Voting Rights
- Broadening and Clarifying Independence
- Reporting Business Relationships
- The Power of Members, Stockholders or Other Persons
- Governance Policies Generally
- Board Review of Form 990
- Compensation Review Process
IRS Scrutiny and Reform Initiatives

Guide Sheet and Check Sheet

Lois Lerner’s April 19, 2012 Speech

- Preliminary Data From Over 1300 cases
- Statistically Significant Correlation Between:
  - Having a written mission statement and good tax compliance
  - Using comparability data always and good tax compliance
  - Requiring full board review of the 990 and good tax compliance
  - Allowing control by small groups and poor tax compliance
Lois Lerner’s April 19, 2012 Speech – Uptick in Fraud

- Part VI, Section A, Item 5: Significant Diversion of Assets

- Review of Operations Research of 2009 Forms 990:
  - 285 organizations reporting $170M in diverted assets
  - Examples: Theft, embezzlement, Ponzi schemes
  - 82 cases resulting in civil or criminal charges (not IRS charges)
  - 47 individuals incarcerated or served probation (not IRS actions)
  - 9 cases of full restitution; 11 cases of partial restitution
Patient Protection and Affordable Care Act

- Strategic, Financial, and Operational Implications
  - Shifting Financial Incentives
  - Reducing Costs
  - Improving Care

- Tax-Exempt Hospitals and Section 501(r)
  - Community Needs Assessment
  - Financial Assistance Policy
  - Charges
  - Billing and Collections

- Supreme Court Decision Expected This Summer
State Scrutiny and Reform Initiatives

- IRS Sharing with State Charity Officials
  - Includes Proposed Denials of Tax-Exempt Status and Tax Returns
  - States Must Comply with Safeguard Standards and Procedures

- New Hampshire Senate Bill 117
  - Would Require Training for Board Chair
  - Would Apply to Organizations Receiving $250,000 From Government
  - Would Introduce Reporting and Penalty Provisions

- Cuomo’s NYS Task Force on Not-for-Profit Entities
  - Task Force Yet to Issue Report
  - Executive Order Capping Compensation at $199,000
  - Waivers for “Good Cause”
Lifespan Corp. v. NEMC

- Affiliation and Disaffiliation
- Lifespan Violated Fiduciary Duties of Care and Loyalty
  - Duty of Care: Grossly negligent in negotiating NEMC’s payor contracts
  - Duty of Loyalty: Willful misconduct covering up conflicts of interest
- Monetary Damages = $14.1 M (Offset by Breach of Contract Claim)

Takeaways
- Intra-System Fiduciary Duties
- Conflict of Interest Policy Review
- Attorney General Intervention in Inter-State Dispute
- CMS Proposed Changes to Hospital Conditions of Participation
In re Lemington Home for the Aged

- “Zone of Insolvency” Revisited
  - Directors Owe Fiduciary Duties to Creditors
  - Business-Judgment Rule Can Be Overcome

- Deepening-Insolvency Theory
  - Not A Viable Cause of Action in Delaware, Tennessee
  - Trend Toward Applying Deferential Business Judgment Rule
In re Lemington Home for the Aged

- Historic Pittsburgh-Area Retirement Facility
- District Court: Summary Judgment for Officers and Directors
  - Business Judgment Rule and In Pari Delicto Doctrine Barred Claims
  - No Evidence of Fraud to Support Deepening Insolvency Claim
- Appeals Court: Vacated District Court Decision and Remanded
  - Absent CEO, “Deplorable” CFO, and Inattentive Board
  - Not Entitled to Business Judgment Rule; In Pari Delicto Not Applicable
  - Signs of Fraud: Admitted No Patients, Omitted Operating Reports, Delayed Bankruptcy Filing, Commingled Funds, Shifted Assets to Related Entity
  - Genuine Issues of Material Fact Remain
Healthcare Board of Directors: Meeting Governance and Compliance Challenges

May 17, 2012

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Indicators That Your Board May Be Ineffective

- Discussions at the board level are superficial
  - Does the chair of the board facilitate in-depth discussions of issues?
  - Do the board members take their responsibility seriously by probing into issues?
  - Are the board members more concerned with the stakeholders than social events?
  - Are board members afraid to upset other board members or senior executives?
Indicators That Your Board May Be Ineffective (cont.)

- The board has little control over its own agenda
  - Each board member should be able to put matters on the agenda.
  - Board members should not be told what is appropriate for the agenda.
  - It is best to have an independent board member set the agenda.
  - Board packets should include the appropriate description of agenda items and relevant background information.
Indicators That Your Board May Be Ineffective (cont.)

- The board never meets without the CEO present
  - Boards should periodically meet in executive session without the CEO and certain other executives.
Indicators That Your Board May Be Ineffective (cont.)

- The board shuns any operational and/or legal review
  - With increasing compliance efforts and scrutiny by regulators, the board should welcome any necessary operational and legal reviews.
Indicators That Your Board May Be Ineffective (cont.)

- Directors have “relationships” (aka conflicts of interest) with the organization
  - Let’s bank with the local bank
  - Let’s be supportive of the local construction company
  - Let’s support the local insurance agency
  - Let’s toss the local lawyer or consultant on the board some work

Are these decisions in the best interests of the stakeholders? How do you know?
Indicators That Your Board May Be Ineffective (cont.)

- On any crucial issues, the board members are “pressured” to support a position of a single person
  - Is there one or more dominant individuals on the board, such as a CEO or Chair?
  - Does the dominant individual seek to stifle board discussions?
  - Are there pre-meetings before the board where one tries to obtain a “consensus”?
Indicators That Your Board May Be Ineffective (cont.)

- As questions are raised at a board meeting, does the board rely on the expertise of a single individual?
  - The lawyer
  - The accountant
  - The insurance executive
  - The banker
  - The architect
Indicators That Your Board May Be Ineffective (cont.)

- There is extensive use of the consent calendar at board meetings
  - A query to a board member—If a decision was approved by virtue of being on the consent calendar and it was not discussed, would you feel comfortable defending the time made or not made on that decision to a jury that might involved in determining potential liability for the board member?
Indicators That Your Board May Be Ineffective (cont.)

- Board members are reticent to ask probing questions
  - Not good reasons not to ask questions
    - I am new
    - It is a dumb question
    - I can rely on someone else to understand this topic
    - I cannot get brickbreaker to work on my blackberry
Board member inquiries about board issues are not referred to a board committee

– All queries should not be referred to the CEO, unless he or she is the appropriate person to address them

– CEOs and Chairs should refer certain queries to board committees
The board or board committees cannot access separate outside legal counsel or consultants

- This should be true not only according to charters and bylaws, but in practice.

The compliance officer does not report to the board of directors

- The compliance officer should have direct access to the audit and compliance committee and to the board of directors.
- The compliance officer should be comfortable in approaching such committee or the board.
Indicators That Your Board May Be Ineffective (cont.)

- There is little turnover in board positions and the board members have a “cozy” relationship with a dominant board chair
  - Board members need to separate their personal relationships from their fiduciary duties
  - There are not separate audit and compensation committees staffed with only outside non-interested directors.
Indicators That Your Board May Be Ineffective (cont.)

- The interests of the stakeholders are ignored
- Some board members appear to be left “out of the loop.”
- Directors are asking about the D&O coverage and their potential liability.
• Officers and Directors have a *fiduciary duty* to the corporation, its shareholders or members, and in some cases to the recipients of its services
• They may also have a fiduciary obligation to creditors and employees
• Officers and Directors are legally required to serve in “good faith”
• Add a heavily regulated industry
• Exempt organizations: Charitable Mission & Economic
ENVIRONMENT (cont.)

- Duty of Care
  - Exercise the care and diligence of an ordinary but prudent person

- Duty of Loyalty
  - Put the interests of the corporation above individual interests and avoid conflicts of interest

- Duty of Obedience
  - Decisions are obedient to the mission of the organization
SARBANES-OXLEY ACT of 2002 (SOX)

Mandated extensive changes in financial reporting, accountability and disclosure systems

- Intended to ensure the accuracy and reliability of financial statements and avoidance of conflicts of interest
- Applies primarily to *publicly* traded companies, except for
  - Whistleblower protections
  - Record retention/destruction
- Many non-SOX entities voluntarily adopted SOX-like policies and procedures as “best practice”
- Several states are developing laws that apply SOA-like provisions to nonprofit organizations
MAJOR GOVERNANCE PRINCIPALS

• Important themes
  – Requirements usually vary based on size of organization
  – Independent Audit Committee requirements
  – Interested party transaction requirements
  – Officer and director compensation controls
  – Certification of financial statements
  – Financial reporting and disclosure controls
  – “Best Practices” pressure from Board members
OTHER GUIDANCE

• OIG Supplemental Hospital Compliance Program (June 2004 and January 2005)


• OIG Resource: “An Integrated Approach To Corporate Compliance” (July 2004)

• OIG/AHLA Educational Resource (April 2003)

• AG Guidance On Internal Controls And Financial Oversight
NON-GOVERNMENTAL PRESSURES

• Other pressures to adopt SOX principles:
  – Bond rating services
  – Lender requirements
  – D&O insurance underwriters
  – Donor demands
  – Auditor guidelines (AICPA)
  – OIG / Sentencing Commission guidance
BEST PRACTICES

• Strengthen Board Oversight
  – Board should develop and implement processes to assure satisfaction of Board duties and business judgment rule
  – *Caremark International* – Board must be provided with detailed and timely information
  – *Disney* – Court reviewed whether board decision was a product of a process that was deliberated in good faith
  – Board has duty to oversee corporate compliance
  – DOCUMENT! -- Board minutes should be detailed and complete
BEST PRACTICES

• Adopt a Code of Ethics/Code of Conduct
  – Since 1997, OIG emphasized development of Code of Conduct in health care
  – Articulates the organization’s commitment to ethical behavior and compliance – applies to all employees
  – Joint product of board, officers, medical staff and other employees
BEST PRACTICES

• Adopt a Conflict of Interest Policy
  – Applies to directors and management
  – Annual disclosure statement
  – Consistent with IRS guidelines
  – Investigation and resolution of conflicts – Should be independent body or members of board (e.g., audit committee)
BEST PRACTICES

- Establish Audit Committee
  - Should be separate from the Finance (or other) Committee
  - Composed solely of non-management members
  - Should have a financial expert
  - Responsible for appointment, compensation and oversight of outside auditor
  - Has the authority to retain outside advisors (e.g., legal counsel)
  - There should be an annual external financial audit
  - It should report regularly to the full Board
BEST PRACTICES

• Monitor Restrictions on Audit Firm
  – The outside auditors should be truly independent, and the appointment process should assure independence
  – The outside auditors should report directly to the Audit Committee
  – The Audit Committee should pre-approve all non-audit services to be provided by the audit firm (e.g., Form 990 preparation vs. internal audit outsourcing services)
BEST PRACTICES

• Management Certification of Financial Statements/Review of Internal Controls
  – The CEO and CFO should sign off on all financial statements and internal controls (either formally or in practice)
  – Audit of Internal controls – cost/benefit analysis
  – If not, there should be a mechanism to ensure that the financial statements “fairly present in all material aspects” the financial condition of the organization (which is the SOA requirement)
  – Any “off balance sheet” transactions should be disclosed
  – The Board should review and approve the financial statements (and Form 990s)
BEST PRACTICES

- Executive Compensation
  - Excessive compensation recurring theme in many corporate scandals
  - Establish Board Executive Compensation Committee to review such arrangements for FMV
  - “Intermediate Sanction” Rules
    - Develop process to identify “Disqualified Persons”
    - Develop process to meet IRS “Rebuttable Presumption”
      - Compensation must be reasonable and supported by appropriate comparability data
      - The basis for the determination must be adequately documented
  - Monitor and Restrict Personal Loans
BEST PRACTICES

• The Importance of Board Minutes
  – Reflect adherence to the entity’s corporate/charitable purposes
  – Document compliance with conflict of interest requirements
  – Adequately describe the depth to which the Board evaluated a material issue, and the presence of dissenting views/votes
    • “Minimalist” vs. “Roadmap to Litigation” approaches
  – Attorney-client privileged and other protected communications must be protected
BEST PRACTICES

- Education of Board Members (and Senior Management)
  - The General Counsel should educate the Board on this topic, especially in regard to the “sea changes” in ethical obligations of corporate counsel re: flow of information “up the ladder”/confidentiality
  - The Board should provide direction
  - Board should ensure General Counsel’s Office is strong and essential part of entity’s control and governance structure
  - The bylaws and policies should be reviewed/revised to address these issues
BEST PRACTICES

• Independence of Compliance Officers
  – Direct line of communication to the Board (or the Audit Committee)
  – Independent authority and budget to hire outside counsel
  – Review Board related compliance/audit issues
  – Help develop compliance plan, including corporate responsibility/governance compliance
  – Help develop procedures to investigate whistleblower complaints and protection from retaliation
  – Help develop policies for mandated document retention/destruction and handling of electronic files
  – Should prepare regular reports to Board
BEST PRACTICES

• Expanded General Counsel Role
  – Direct line of communication to the Board (or Legal Committee)
  – Regular executive session meetings with the Board (or Legal Committee)
  – Actively involved in Board education re: governance responsibilities/compliance
  – Board oversight of the GC’s retention, compensation, evaluation and termination
BEST PRACTICES

• Expanded General Counsel Role
  – Serve as “staff” to key Board committees (e.g., audit, executive compensation, compliance, nominating)
  – Serve as (or support) corporate secretary
  – Help direct corporate responsibility/governance compliance efforts
BEST PRACTICES

• Expanded General Counsel Role
  – Advise the Board on selection of key independent advisors (e.g., auditors, compensation consultants, valuation consultants, independent counsel)
  – Each attorney (in-house and outside) representing the entity should serve the interests of the entity and not the personal interests of any individual officer, director or employee
  – All outside counsel should report directly to the GC (who will have a direct line of communication to the Board)
  – Ultimate client is the Board!
CORPORATE COMPLIANCE

- REQUIRED – PPACA
- Board duty to oversee corporate compliance
- Policies and procedures to reduce and discourage fraud and abuse
- Demonstrates the organization's commitment to honest and responsible corporate conduct
- Increases the likelihood of preventing, identifying and correcting unlawful behavior at early stage
- Encourages employees to report potential problems before government intervention
CORPORATE COMPLIANCE

• Basic Elements of Compliance Plan
  – Corp Compliance Officer
  – Policies and Procedures
  – Open communication -- Hotline
  – Training and Education
  – Internal Monitoring and Auditing
  – Process to Respond to Detected Deficiencies and Corrective Action Plans, Including Self Reporting
  – Disciplinary action for violators
CORPORATE COMPLIANCE

- Benchmarks of an Effective Compliance Plan
  - Each board member takes responsibility and understands role
  - Buy-In from board and key management
  - Corporate culture that EVERYONE is a compliance officer
  - Appropriate training of all key management and personnel regarding policies and procedures
  - Updated training of new developments and responding to new trends
  - System to report breaches
  - Swift action to investigate and resolve
  - Periodic updates to board
CORPORATE COMPLIANCE

• Benchmarks of an Effective Compliance Plan
  – Investment and utilization of information technology
  – Periodic risk assessment
    • Outpatient Procedure Coding
    • Review of physician relationships
      – Stark -- Exceptions
      – Anti-Kickback – Exceptions/Safe Harbors
    • Joint ventures with referral sources
    • Compensation relationships with physicians
      – FMV & Commercially Reasonable
      – Recruitment arrangements
      – Physician leasing arrangements
• Discounts and FREE items or services
• Charity care practices
CORPORATE COMPLIANCE

• Consequences of a Failed Compliance Plan
  – Significant penalties
  – Corporate Integrity Agreement
  – Deferred Prosecution Agreement
  – Possible exclusion from Federal Health Programs
  – Criminal Prosecution
  – Qui Tam actions
Applicability of CMS Rules

- ACOs participating in the new Medicare Shared Savings Program must have
  - A mechanism for shared governance
  - Appropriate proportionate control for ACO participants
Governing Bodies of an ACO may be

- A board of directors
- A board of managers
- Any other governing body that provides a mechanism for shared governance and decision making
ACO participants

- Must have a 75% control of the governing body
- Must choose a representative from their organization to represent them on the governing body.
The board’s primary role should be strategic advisor and supervisor of management
  – It should not be an enforcer of legal and regulatory requirements

The board’s size should be limited to enhance its effectiveness
  – Seven to thirteen may be a good size
The Future of Board Governance – General (cont.)

- Board members should be chosen for their key competencies
  - What do they add to the board and board process and how well do they “play with” other board members

- The board’s leadership structure should work for the particular board and management team
The Future of Board Governance – ACO Related

- May be tied to successful strategies for an ACO or an entity in value-based purchasing
  - There will be a clearly articulated patient-centered strategic plan
    - with goals and benchmarks that can serve as the basis for program management
    - focusing on the new entity, no matter how configured
The Future of Board Governance – ACO Related (cont.)

- Will depend upon whether the various constituents can capitalize on each partner’s strengths. And of course, minimize their weaknesses.

- Will help to ensure that the allocation of capital and resources are consistent with an ACO’s goals and objectives.
The Future of Board Governance – ACO Related (cont.)

- Will include mechanisms to foster effective leadership
  - Alternatives may include
    - creating physician practice divisions or a corporation led by a physician executive
    - bifurcating the positions of CEO and president with a physician holding one of the positions
    - having a physician as chair of the board of directors
Ensure that board members are engaged in governance

- consider the ACO’s goals and objectives
- are any stakeholders suited to being on the board
- avoid appointing hospital or physician centric members to the board
- consider a combination of individuals who have both governance skills and the diversity of interests, talents and backgrounds with which to govern a patient-centered, value-focused organization
May depend, in part, on the legal and organizational structures that will best facilitate an integrated ACO model

Consider including the following committees:

- Executive Committee
- Finance Committee
- IT Committee
- QA/UR Committee
- Governance Committee
The Future of Board Governance – ACO Related (cont.)

- Employ technology to fulfill the needs of a clinical integrated, patient-centered organization

  Keep the board abreast of operations with
  - Dashboards
  - Scorecards
  - Other tools for creating alignment and good governance