



# *The Dallas-Fort Worth Hospital Council and Texas Healthcare Trustees*

*Present*

## **Trustee Responsibilities: Managing Your Risks Related to Executive and Physician Compensation Today and After Health Care Reform**

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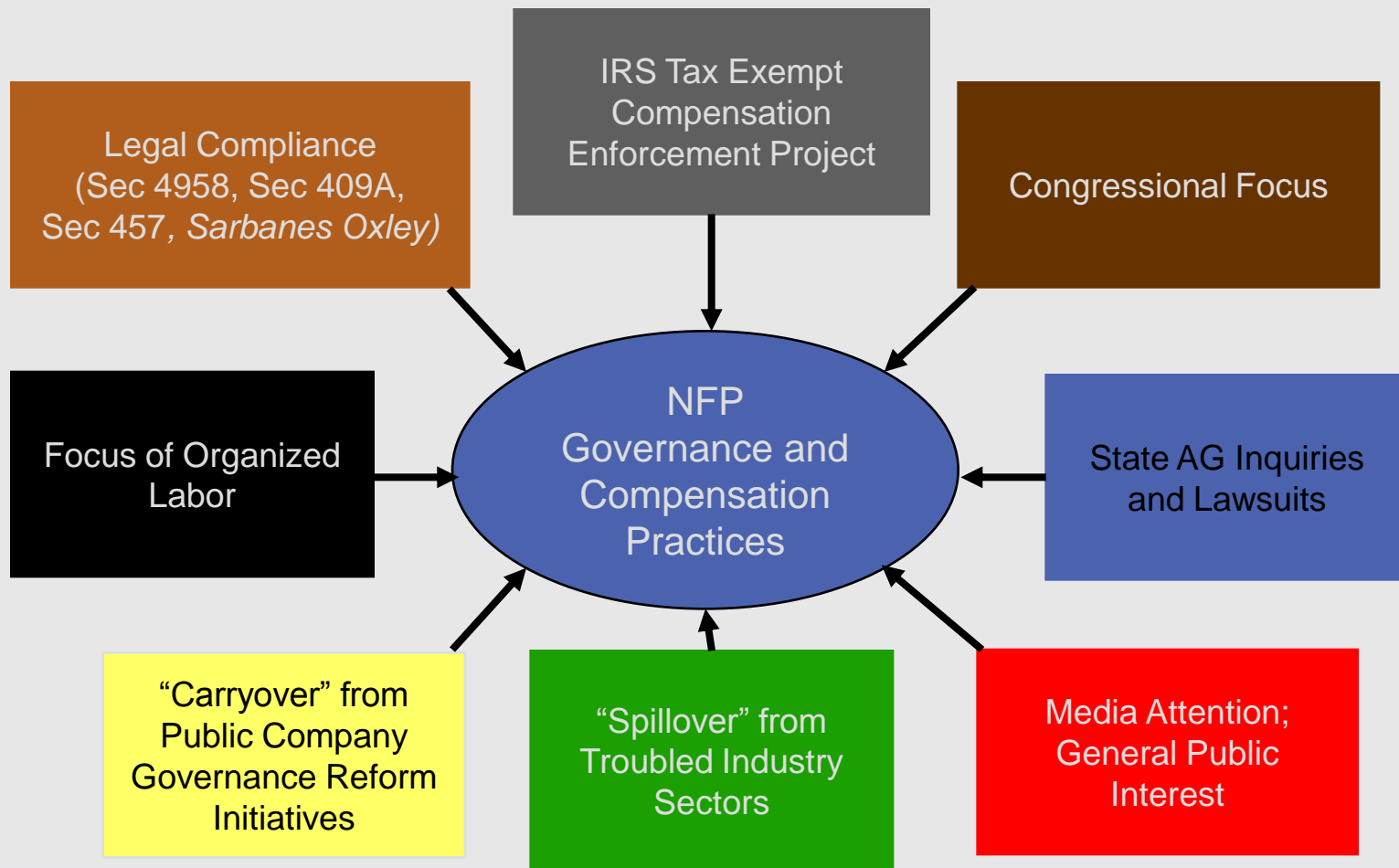
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# Topics

- > **Regulatory Environment**
- > **Key Themes and Trends**
- > **What Trustees Should Be Looking For**
- > **What Trustees Should Know About Physician Compensation**
- > **Areas to Focus on in 2009 and 2010**
- > **Questions & Answers**

# Pressure is Coming from All Directions



# Regulatory Requirements

## INTERMEDIATE SANCTIONS (IRS Code Section 4958)

- Requires that compensation paid to disqualified persons be reasonable
  - A disqualified person is any person who is in a position to exercise substantial influence over the affairs of a tax-exempt organization
  - Compensation includes total compensation (i.e., salary, incentives, benefits, perquisites, deferred compensation, or any item of value provided to an executive)
- If compensation is found to be unreasonable or excessive, executives and board members are subject to penalties

# Regulatory Requirements

## INTERMEDIATE SANCTIONS (IRS Code Section 4958)

- If compensation is found to be unreasonable or excessive, executives and board members are subject to penalties
  - Executives (disqualified persons):
    - > Repayment of excess benefit
    - > Plus a penalty equal to 25% of the excess benefit
  - Board members who knowingly participated in the transaction:
    - > 10% of excess benefit
    - > Up to \$20,000 per transaction

# Regulatory Requirements

## **REBUTTABLE PRESUMPTION (SAFE HARBOR)**

**Intermediate Sanctions regulations outline specific guidance for not-for-profit 501(c)(3) and (c)(4) organizations to follow to ensure reasonable compensation for “disqualified persons”**

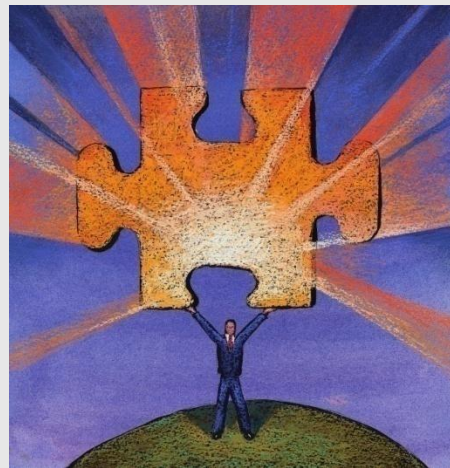
- 1. An independent Committee, comprised of individuals unrelated to and not subject to the control of executives, with no material financial interest in the transaction, reviews and approves compensation decisions for selected individuals (“disqualified persons”)**
- 2. The Committee relies on data for functionally comparable positions prior to making decisions representative of compensation “ordinarily provided by similarly-situated organizations, under like circumstances”**
- 3. The Committee prepares adequate documentation at the time that compensation decisions are made**

# Board Review Best Practices

- **Substantial conflict of interest policy**
- **Rebuttable presumption of reasonableness**
- **Independent Compensation Committee**
- **Independent Audit Committee**
- **Full Board approval of CEO compensation, periodic review of staff compensation program**
- **Understanding and oversight of physician compensation arrangements**
- **Know your Form 990**



# Key Themes and Trends



# Key Themes

- **There will be increased scrutiny of healthcare executive and physician compensation in 2009 and 2010.**
- **Pressures are building to exert greater external control over executive compensation decision-making.**
- **OLG actively pursuing physician compensation arrangements (fraud & abuse/anti-kick back).**
- **Board members are increasingly “nervous”.**
- **The best people are still expensive.**

# Trend One

- The current environment is creating **skepticism/anger** regarding common executive compensation approaches:
  - Loans.
  - Country club memberships.
  - Spouse travel.
  - Incentive plan design.
  - Severance/change in control.
  - Retention plans.
  - Total compensation.

## Trend Two

- Increasingly, members of legislative bodies, regulatory agencies and the media perceive that
  - Public policy requires executives of non-profit organizations to accept a **discounted level of compensation.**
  - Physician compensation rewards **production** while emphasis should be on **quality and/or preventive care.**

## Trend Three

- **Secondary items (e.g., discretionary expenditures, travel and entertainment expenses, executive use of corporate assets, country club memberships) often play a disproportionately significant role in regulatory review, media scrutiny and congressional focus.**

## Trend Four

- Greater focus placed upon the **independence** of compensation committee members **and** the compensation consultant.

## Trend Five

- Expanding policy interpretations of the board's oversight obligations and of the importance of "transparency" are **eroding efficiencies** achieved by delegation of oversight responsibilities to the compensation committee.

## Trend Six

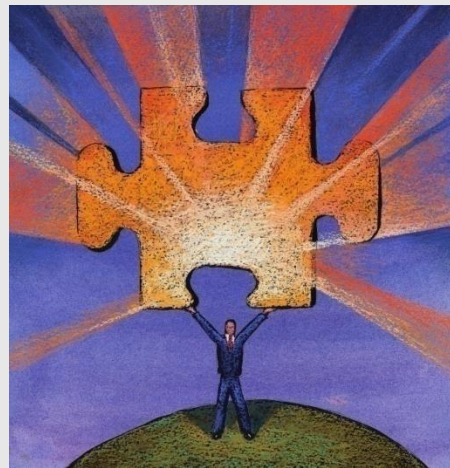
- Significantly increased importance of **public reporting documents**, particularly with respect to executive compensation:
  - Requires increased organizational resources.
  - Impacts program design.

# Trend Seven

- The speed and intensity of new executive compensation-related developments leave **little room for organizational self-satisfaction:**
  - Policies and procedures must be revisited repeatedly to ensure effectiveness, e.g.,
    - Incentive compensation
    - Flexible benefits
    - Supplemental executive retirement
    - Perquisites



# What Trustees Should Be Looking For



# Top 10 Things Trustees Should Look For

1. **Independence of Compensation Committee Members**
2. **Independence of Compensation Committee Advisors**
3. **Identification of all disqualified persons**
4. **Management control and personal advocacy**
5. **Presence of an “Aspirational” Peer Group**
6. **Incentive compensation program measures and payout levels**
7. **Compensation levels on the “upper-end” of market**
8. **Unpaid vacation accruals**
9. **Expense reimbursement policies**
10. **“Lake Wobegon” effect**

# What Trustees Should Be Looking For

## #1. INDEPENDENCE OF COMPENSATION COMMITTEE MEMBERS

- **Suggestions/Recommendations**
  - Develop strong conflict of interest (COI) policy
  - Consider using IRS model from web site if the general board policy isn't specific enough
  - If COI exist (smaller communities), strict enforcement of recusal
  - Consider a set committee membership rotation
  - Start every meeting at which transactions are going to be approved, with a review of the COI policy
    - Ask if COI exists
    - Document in minutes

# What Trustees Should Be Looking For

## #2. INDEPENDENCE OF COMPENSATION COMMITTEE ADVISORS

- **Suggestions/Recommendations**
  - Committee select and retain advisors
  - Engagement letter from Chair to advisors
    - Advisor report to committee
    - Draft report to chair prior to distribution to management
    - Etc.
  - Advisors required to disclose in writing any other work advisor's firm does for EO

# What Trustees Should Be Looking For

## #3. IDENTIFYING ALL DISQUALIFIED PERSONS IN EO

- **Family members of disqualified persons**
  - **Tendency of EO is to stop after executives review is complete**
  - **Including family members may overwhelm over-worked committees**

- **Suggestions/Recommendations**

- Consider more decentralized approach using local boards
  - System CEO serves on local compensation committees
- Schedule multiple year-end meeting to review total compensation/  
establish rebuttable presumption
- Review all disqualified persons, extra discussion/focus on outliers

# What Trustees Should Be Looking For

## #4. MANAGEMENT CONTROL/PERSONAL ADVOCACY

- **Suggestions/Recommendations**
  - Advisors retained and report to committee
  - Formal engagement letter with process spelled out
  - Advisors should keep chair in correspondence loop
  - Every committee meeting should have an executive session
  - Chair should specifically ask advisors in executive session:
    - Has any member of management contacted you to attempt to influence you or lobby you on matters of executive compensation?

# What Trustees Should Be Looking For

## #5. ASPIRATIONAL PEER GROUP

- **Statement:** EO strategic plan calls for moving from \$1.0B in net revenues to \$5.0B over next five years
- **Recruitment:** Must recruit executives with proven track record from organizations reflective of strategy
- **Pay Strategy:** Need to pay executive team based on aspirational peer group

### Suggestions/Recommendations

- Review requirements for establishing rebuttable presumption of reasonableness (“similarly situated organization”)
- Review Final Intermediate Sanctions regulations – Example Six

# What Trustees Should Be Looking For

## #6. INCENTIVE COMPENSATION

- **Suggestions/Recommendations**
  - Management should provide the Committee, for each measure:
    - Historical performance on incentive measure
    - Industry benchmark
  - Mandate committee involvement
    - Vet performance metrics at start of FY
    - Ensure enough stretch in measures
    - Review cost of incentive plans at Threshold, Target and Maximum at the start of FY
    - Validate financial performance against audited financials
  - Hold the line against “mid-stream” or “after the fact” changes and enhancements

# What Trustees Should Be Looking For

## #7. UPPER-END OF MARKET COMPENSATION

**Value Indicators** and **Business Judgment** should be used to support  
The committee's decision-making

1. Unique/additional responsibilities (e.g., those which are not prevalent in comparable markets)
2. Difficulty recruiting and retaining a key position
3. Unique qualifications, skills and proven experience
4. Leadership succession
5. Achievement of outstanding results (e.g., compared to standard industry benchmarks)
6. Recruitment threat
7. Actual offers of employment
8. Critical stage of organizational development
9. Competitive market pressures

# What Trustees Should Be Looking For

## #8. UNCAPPED VACATION ACCRUALS

### Suggestions/Recommendation

- Examine all policies related to executive compensation
- Use Tally Sheet for each executive
  - Review with committee
  - Tally Sheets need to include not only current cost of compensation but future liabilities should there be an involuntary termination
    - Severance
    - Accrued PTO
    - Incentive payouts (LTIPs)
    - ?

# What Trustees Should Be Looking For

## Other issues

### # 9. EXPENSE REIMBURSEMENT

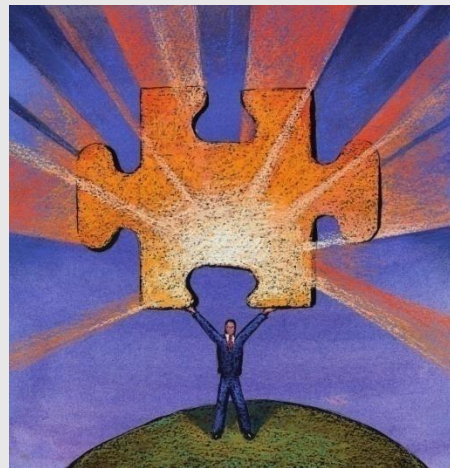
- Use of non-accountable plans
- Some expenses should be categorized as compensation

### #10. LAKE WOBEGON EFFECT

- All of our executive are significantly above average
- We need to pay at the 75<sup>th</sup> percentile
- This year's 75<sup>th</sup> is next year's 50<sup>th</sup> percentile

**Lake Wobegon**  
*where all the women are strong,  
all the men are good-looking, and  
all the children are above average.*





# What Trustees Should Know About Physician Compensation

# What Trustees Should Know About Physician Compensation

## Hospital-MD relationships must withstand scrutiny

- Stark Law
- Anti-Kickback Statute
- Civil Monetary Penalty Statute
- Tax-Exemption Requirements
- State laws
  - > Physician anti-referral requirements
  - > Corporate practice of medicine

**Recurring Theme: compensation paid to physicians must be at Fair Market Value.**

# What Trustees Should Know About Physician Compensation

## When do you need a FMV assessment

- Medical directorship agreements
- Professional services agreements
- Hospital leasing arrangements
- Joint ventures with physicians
- Call coverage pay
- Anytime money changes hand between a hospital and a physician

# What Trustees Should Know About Physician Compensation

- **The basic requirements regarding hospitals' agreements with most physicians have not changed.**
- **Such agreements must:**
  - > **Be written,**
  - > **Be signed,**
  - > **Last for a term of at least one year,**
  - > **Provide for fair market value compensation, and**
  - > **Set compensation in a manner that does not vary with the volume or value of referrals.**

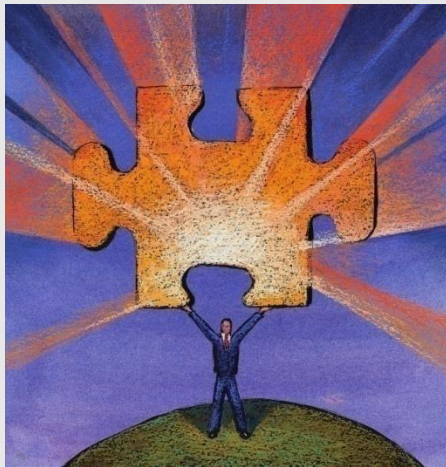
# What Trustees Should Know About Physician Compensation

## Stark – FMV

- **Fair Market Value** means the value in **arm's-length transactions** consistent with the general market value
- “General Market Value” means the compensation that would be included in a service agreement as a **result of a bona fide bargaining between well-informed parties** who are not otherwise in a position to generate business for the other party at the time of the agreement
- Usually the fair market price is the compensation that has been included in bona fide service agreements with comparable terms at the time of the agreement where the compensation **has not been determine in any manner that takes into account the value or volume of anticipated or actual referrals**



# Areas to Focus on in 2009 and 2010



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*"I'm overcompensated, but I'm not overcompensated enough."*

## Focus Area One: Governance

- **Ensure approval body and consultant independence.**
- **Ensure compensation decisions are guided by proper business judgment reflective of current economic conditions.**
- **Focus on due diligence (i.e., rebuttable presumption of reasonableness).**
- **Ensure comprehensive documentation of process and decisions.**
- **Increase full Board disclosure/involvement.**

# Consider Board’s Responsibility Across ALL Programs

Define Executive Total Compensation Strategy	
<ul style="list-style-type: none"> <li>■ The Committee determines, and periodically updates, the executives under their jurisdiction (e.g., CEO and direct reports).</li> </ul>	<input type="checkbox"/>
<ul style="list-style-type: none"> <li>■ The Committee defines the objectives of executive compensation and benefit programs to support the recruitment and retention of talented, experienced staff, thereby enabling the organization to fulfill its mission and strategy.</li> </ul>	<input type="checkbox"/>
<ul style="list-style-type: none"> <li>■ The Committee ensures that decisions about executive total compensation are fiscally responsible and affordable, both in the short and long term.</li> </ul>	<input type="checkbox"/>
<ul style="list-style-type: none"> <li>■ The Committee ensures that benefit decisions are reviewed for compliance with fiduciary requirements, including, but not limited to, the “prudent person” and “exclusive benefit” provisions under Federal regulations and governing Acts.</li> </ul>	<input type="checkbox"/>
<ul style="list-style-type: none"> <li>■ The Committee evaluates and approves organizational performance objectives on both an annual and long-term basis, and targets those goals with the greatest impact on mission and strategy. The Committee ensures effective and comprehensive review of CEO performance relative to these goals.</li> </ul>	<input type="checkbox"/>
<ul style="list-style-type: none"> <li>■ The Committee ensures fair and equitable decisions about executive total compensation plans, and is mindful of the “optics” of these decisions relative to public, employee and media opinion.</li> </ul>	<input type="checkbox"/>
<ul style="list-style-type: none"> <li>■ The Committee receives regular updates and education on executive compensation and benefit trends, and determines how such developments affect compensation program strategy and design.</li> </ul>	<input type="checkbox"/>

## Focus Area Two: Base Salaries

- **Smaller salary increase budgets in 2009 and 2010 (?)**
  - **Provided only when broad-based employee group receive increases.**
  - **That do not exceed overall employee salary increase budgets.**
- **Are salary freezes/reductions useful tools?**

## Focus Area Three: Incentives

- **Provide ability to modify/eliminate incentive awards if significant performance failures occur.**
  - **Consider “clawback” provisions.**
- **Establish controls to ensure that:**
  - **Program does not encourage inappropriate risk-taking.**
  - **Awards are not “enhanced” by economic stimulus dollars.**
- **Near term expect lower incentives due to economic conditions.**

## Focus Area Four: **Benefits**

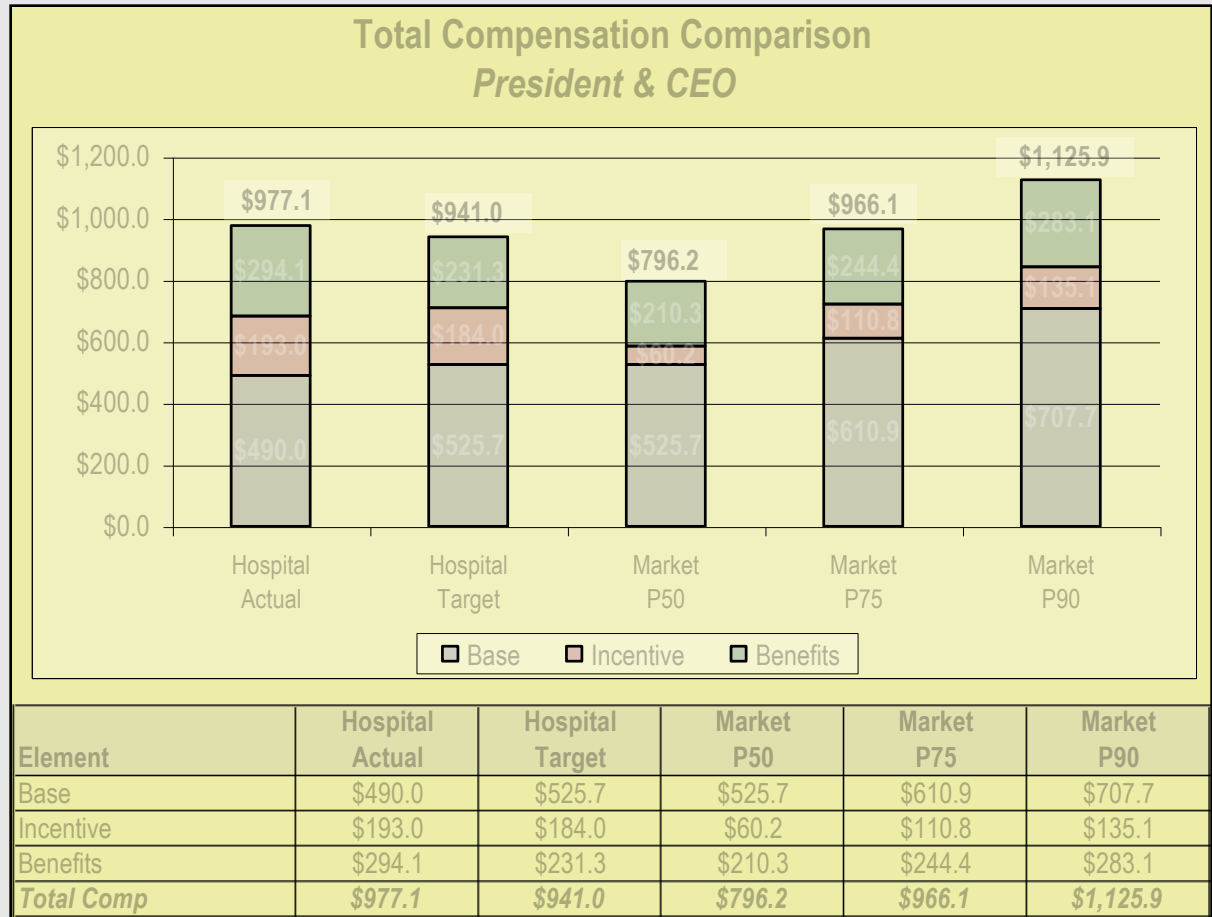
- **Review cost, reporting and delivery of supplemental retirement benefits.**
  - **Movement toward DC approaches.**
- **Review severance provisions for appropriateness and affordability.**
- **Decrease use/eliminate non-essential or highly visible perquisites.**
  - **Country clubs.**
  - **Spouse travel.**
  - **Financial counseling.**

# Focus Area Five: Total Compensation

Hospital Revenue = \$450M

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Estimated Market Values Based on Organizations with Revenues from \$400-\$500M



# Focus Area Six: Disclosure

Program Component	Employer Annual Cost			
	Executive 1	Executive 2	Executive 3	Executive 4
Cash Compensation	\$0	\$0	\$0	\$0
Legally Required Benefits	\$0	\$0	\$0	\$0
Standard Qualified Benefits	\$0	\$0	\$0	\$0
Supplemental/Nonqualified Benefits	\$0	\$0	\$0	\$0
Other Benefits/Perquisites	\$0	\$0	\$0	\$0
<b>Total Compensation Cost</b>	\$0	\$0	\$0	\$0
Other Potential Cost/ Cash Flow Items	\$0	\$0	\$0	\$0

# Focus Area Seven: Expense Reimbursement

- **Pay closer attention to executive expense payments and reimbursements for purposes of:**
  - **Proper tax treatment.**
  - **Compliance with internal financial controls.**
  - **Compliance with reporting rules.**

## Focus Area Eight: **New Form 990**

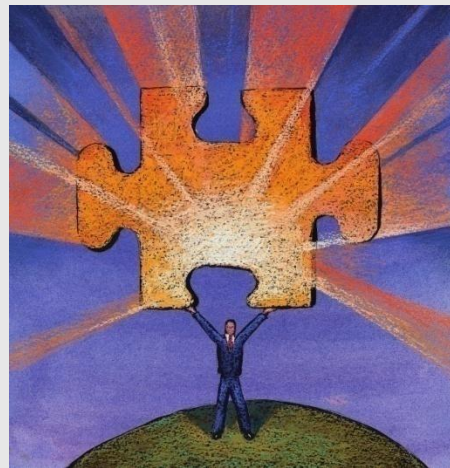
- **Gain an understanding of compensation reporting implications – develop pro-formas.**
- **Coordinate with committees and staff to ensure complete and accurate reporting of compensation.**
- **Obtain guidance from legal counsel to develop appropriate supporting narratives.**
- **Review compensation reporting with appropriate board committee(s) prior to filing.**
- **Make full board aware of compensation disclosures.**

## Focus Area Nine: Media

- Anticipate the potential for **periodic media inquiries** concerning executive compensation:
  - Prepare a related public relations strategy.
  - Appoint a qualified media spokesperson.
  - Develop supporting materials and data.
  - Prepare board members.
- **Key Theme: A major economic engine.**



# Questions & Answers



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