A Perfect Storm: Health Care Reform and Economic Forces Require Greater Board Oversight of Physician Compensation

The current transformational wave of health care reform, the economic downturn, the onerous regulatory arena and the highly competitive physician labor market have created the “perfect storm” with regard to managing physician compensation. Health care organizations increasingly are integrating physicians through employment and acquisition opportunities to build scale and lay the foundation for new clinical delivery models. As this occurs, physician expenditures will become a more significant portion of many organizations’ operations. Concurrently, organizations have to balance increased competition within the physician labor market with complex regulatory requirements. As a result, executives and board members must cautiously navigate through this environment. Proactive physician compensation planning, education and the adoption of governance best practice approaches are critical.

The Environment

Governing boards and compensation committees have a fiduciary responsibility to oversee physician integration activities, which are being pursued at record levels across the country. The U.S. Department of Labor forecasts that under current health care reform scenarios, hospital employment of physicians is expected to increase by 22 percent over the next ten years, which represents a transformational change in the physician labor market. At the same time, hospitals face significant competition to secure key physicians and grow service lines, all in a climate of increased regulatory scrutiny of fraudulent activities and specific challenges to physician compensation arrangements. In 2010 alone, the U.S. Department of Justice (DOJ) recovered more than $2.5 billion in health care fraud settlements.
And since 2009, the DOJ has recovered $4.6 billion in False Claims Act cases.

Other regulations also influence how organizations will be able to pay their physicians. The key statutes and regulations that impact physician compensation arrangements include Stark, anti-kickback, tax-exempt laws under Internal Revenue Code 501(c)(3), and civil monetary penalty (CMP). In addition, momentum is building to use the Responsible Corporate Officer Doctrine to hold health care executives and officers personally accountable for organizational misconduct.

Three of the statutes and regulations—diagrammed below—have a common requirement that physician compensation arrangements must represent *fair market value (FMV)*.

In addition to ensuring that physician compensation arrangements represent FMV, Stark and anti-kickback regulations require that the arrangements be *commercially reasonable*. FMV relates more often to the quantitative analysis of the arrangement, while commercial reasonableness relates to the broader business factors that support the basis for the arrangement.

Significant consequences can result if any or a combination of these statutes is violated, including but not limited to:

- Fines and penalties, including $11,000 per claim and treble damages for false claims
- Exclusion from Medicare/Medicaid programs
- Imprisonment
- Reputational risk
- Public and media scrutiny
- Financial cost of investigations
- Staff time required to address investigations

Beyond the regulations governing physician compensation and financial arrangements, IRS Form 990 reporting requires not-for-profit health care organizations to publicly disclose information on highly compensated individuals. This may include physicians under both employment and contractual arrangements. Such public disclosures can elicit considerable media and public scrutiny that governing boards and compensation committees must be prepared to address.

### The Importance of Governance

In light of the legal and regulatory environment, disclosure requirements and the increasing prominence of physician employment within organizations, it is imperative that organizations have effective governance of physician compensation. This includes ensuring that governing boards and compensation committees are educated on key regulatory matters, are well informed of their organization’s physician compensation arrangements and use proper governance structures. These arrangements represent not only substantial strategic and financial investments for the organization, but also pose a significant risk if not properly structured, managed and reviewed. Good governance processes help ensure that physician compensation arrangements receive appropriate review by the governing body so they are in the best interests of the organization and beyond reproach.

Effective governance also can support the organization’s financial objectives. A recent Moody’s Investor Services Special Comment publication (December 20, 2010) highlighted five specific governance practices that Moody’s believes may contribute favorably to a health care organization’s credit rating:

- Stable and capable board and senior management team
- Structured oversight and disclosure processes that serve to reduce risk and enhance effectiveness
- Execution of short-term and long-term strategic planning to optimize resource allocation
- A commitment to board self-assessment and benchmarking to promote ongoing governance improvement
- Effective board oversight of government and regulatory relations

As a result, governing boards and compensation committees that stay current on these complex physician compensation matters – and adopt best governance practices – will not only help their organization achieve its growth objectives and strategic physician alignment goals, but they may also enhance its overall financial outlook and stability.

**Action Steps**

Organizations would be well served to consider the following action steps to support effective governance of physician compensation arrangements:

1. **Educate the governing board and compensation committee.** Use education sessions and leadership retreats to update the governing board and compensation committee on key physician compensation trends, compliance responsibilities, and the procedures that should be in place and followed to avoid compliance pitfalls. Core focus areas may include:
   - Regulatory compliance related to:
     - Stark laws
     - Anti-kickback statutes
     - IRS Form 990 reporting requirements
     - Intermediate sanctions
     - OIG (Office of Inspector General) opinions
     - Civil monetary penalties
   - Physician labor market trends
   - Physician compensation trends
   - CMS (Centers for Medicare and Medicaid Services) activity related to demonstration projects, waivers and innovation zone activities

2. **Ensure proper oversight and consider establishing a dedicated committee.** If a committee with responsibility for physician compensation matters is not already in place and active, consider establishing one comprised of disinterested governing board members, free from bias or self-interest, to oversee physician compensation matters. This may be accomplished either by adding responsibilities to an existing compensation committee or forming a brand new group focused only on physician matters. When deciding whether to use an existing committee or create a new one, organizations should consider factors such as the volume of arrangements to review, the members’ skill sets, potential conflicts of interest and the level of external pressure on or scrutiny of physician compensation arrangements.

3. **Develop guiding principles and document processes.** These can include the committee’s philosophy statement regarding physician compensation and the charter documenting the committee’s roles and responsibilities. A sample of key items to document:
   - Guiding principles that address such issues as target market position and key variables that will impact physician compensation (e.g., productivity, performance, years of service, effect of the national or local labor market)
   - Preapproved ranges or thresholds and parameters for defining reasonable compensation
   - Review schedule
   - Benefits and impact of total compensation

4. **Determine which arrangements to review.** The committee will need to review and approve policies for deciding which arrangements will require review. For example, these may include all chair and physician leadership positions, incumbents with compensation over the 75th or 90th percentile of the market, arrangements with large incentive or retention bonuses, positions meeting the “disqualified person” definition under intermediate sanctions, or any physicians with a family member in a key leadership role.
5 Conduct an audit of the compensation program. The committee should establish a schedule, at least annually, to review the physician compensation arrangements to ensure consistency with its philosophy and established guiding principles, as well as to stay current with changes in compliance regulations. The audit would include reviewing the competitiveness of the program, examining incentive arrangements, evaluating benefits arrangements and assessing special retention or other payments.

6 Get engaged with transactions early. The committee responsible for physician compensation should be proactive and involved from the start of a transaction to make sure it is consistent with FMV and substantiated with appropriate business judgment. The committee should also ensure that documentation is comprehensive enough to support regulatory and tax-exempt compliance.

7 Test models that align compensation with hospital reimbursement for services. The committee should ensure that payments to physicians are consistent with productivity, quality and any other variables used in the approved models to compensate physicians.

8 Update the full board. The full board of the organization should be appraised of the compensation committee’s actions and decisions, especially related to “high-risk” issues. Board members also should be prepared with talking points and communications to respond to potential scrutiny that may come from the media, the community at large, or other hospitals and physicians.

Conclusion: As new models of care delivery appear on the horizon, governing boards and compensation committees that effectively oversee physician compensation arrangements and adopt practices to ensure FMV and compliance with regulatory requirements will support their organization’s strategy and success in furthering hospital-physician alignment. They also will help the organization mitigate risk and navigate through this choppy period of health care reform into more tranquil waters.

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