

# A Unique Approach to Assessing Board Committee Effectiveness

by Mary K. Totten

As a focus on continuous improvement has permeated work culture in many industries, performance assessment strategies and tools are becoming integrated into routine organizational and leadership practices. Leading health care governing boards are embracing this trend by participating in more frequent and formal evaluation of board performance. Once an annual or biannual assessment of how well the full board carries out its roles and responsibilities, board evaluation today takes many forms, including individual director and board leader assessment and evaluation of board and committee meetings. These assessments are typically conducted by either the board itself or with the support of outside resources.

In 2013, Kaiser Foundation Health Plan, Inc. / Kaiser Foundation Hospitals will complete a multi-year audit of the effectiveness and accountability of its board's six key committees using a unique approach—having the assessment conducted by Kaiser's Internal Audit Services function.

## The Process

While Kaiser's first board committee audit was conducted in 2008, preparing for it began three years earlier when Internal Audit Services was getting ready for its first external quality-assessment review. Using definitions and standards developed by the Institute of Internal Auditors (IIA) to conduct a rigorous self-assessment of its own practices they reflected on the extent to which they brought a systematic and disciplined approach to evaluating and improving governance processes and overall effectiveness. While Internal Audit Services had been involved in some aspects of governance work, such as assessing the organization's anti-fraud program, reviewing board-related expenses and making recommendations to enhance risk management and internal controls, they had taken less of a role in directly "evaluating governance processes," as suggested by IIA standards.

Kaiser's internal auditors began researching how other organizations were using the internal audit function to improve governance effectiveness and soon entered uncharted territory. Resources from the National Association of Corporate

Directors and IIA helped Kaiser's internal auditors confirm that they were already performing many of the typical governance-related activities that internal auditing groups conduct. Desiring to move beyond the status quo, Cindy Overmyer, senior vice president (then vice president) of Internal Audit Services, and Neal Purcell, then chair of the board's audit and compliance committee, determined that performing an audit of a board committee might be an emerging best practice. If successful, an initial audit could then serve as a pilot for other committee audits as well.

Overmyer gained support from Kaiser Chairman and CEO George Halvorson and the board's governance, accountability and nominating committee, which oversees the effectiveness of board committees. The governance committee volunteered to be the first committee audited. The only requirements the board and management established were that the audit be performed with objectivity and independence, incorporate best practices and deliver candid findings.

The 2008 audit of the governance committee examined its activities and evaluated its charter and the company's corporate governance guidelines against best practices in areas such as director qualifications, the corporate code of ethics, annual board performance evaluations and the role of the board convener. Because Kaiser's CEO also serves as board chairman, an independent board convener approves board meeting agendas and schedules, presides at all meetings of non-management directors and at executive sessions, is the liaison to the board's independent directors and generally balances the board and CEO functions. Auditors identified best practices using resources such as Sarbanes-Oxley requirements, governance policies of other large organizations and the Conference Board's report of the Commission on Public Trust and Private Enterprise.

In reviewing committee responsibilities and authority as stated in its charter, the audit considered:

- corporate governance guidelines;
- committee member qualifications;

- overall committee composition;
- conflict-of-interest practices;
- directors' and officers' liability insurance coverage;
- committee review of corporate documents, strategic plan performance and the board self-evaluation process;
- documentation of committee proceedings and decisions; and
- the committee's communications with management.

The audit was conducted by a senior Internal Audit Services manager who observed committee meetings to assess areas such as the dynamics of interaction between committee members and senior management and whether enough time was devoted to agenda items. The auditor also interviewed the committee chair, board chair and assistant secretary of the board.

The audit team's final report included a "meets expectations" opinion—the highest rating given by Internal Audit Services—and contained no audit findings or recommendations. This positive experience and outcome paved the way for audits of the remaining five key board committees, which were conducted from 2009-2013.

According to Overmyer, the remaining audits identified very few issues, mainly the need to update some committee charters to ensure they are consistent with committee activities and to standardize reporting formats so that the information for committee members is easier to use.

"The biggest benefit of the audit process has been the additional comfort and confidence board members now have that they are accomplishing their chartered committee responsibilities and meeting their fiduciary requirements," she says.

#### Suggestions for Boards

For other boards interested in an internal audit of their committees' effectiveness, Overmyer offers these observations:

- **Consider the maturity of the internal audit function and the board.** Historically, the image of the hospital internal audit function was sometimes associated with billing and coding activities and might be perceived to play a narrow role. Internal audit has broadened its scope to focus on other business and compliance risks as well as risks associated with various forms of strategic engagement. This broader role has raised the perception of the internal audit function's credibility and capability in working with an organization's management and board. In order for internal auditors to effectively conduct a

governance-focused audit they also need to be mission-focused; able to assess group dynamics; and capable of handling complex, sometimes ambiguous subjects. For boards to benefit from an audit they need to be open to ideas for improvement, focused on best practices, and able to view audit findings as learning opportunities.

- **"Socialize" the audit idea.** Before deciding to conduct an audit, it is important that key stakeholders, including management and the board, support it. Overmyer had initial conversations with Kaiser's CEO, general counsel, CFO and the board's governance and audit committee chairs to explain the audit concept, address their questions and concerns and gain their support. Issues they explored included:

- ◇ What will internal audit do with the findings?
- ◇ If the audit identifies a fiduciary concern, are the board and general counsel prepared to address it appropriately?
- ◇ Are the board and management comfortable with the auditor? Because confidential and proprietary information is likely to be shared during an audit, there should be confidence in internal audit's treatment of the information. While the internal audit function typically handles confidential information, this is an appropriate discussion to

have. Also, because many committee topics are highly sensitive and complex, Internal Audit Services appointed a senior-level audit manager with the ability to understand committee discussions and to apply the appropriate level of judgment to interpret them.



- ◇ At what level will the audit be performed? Will the internal auditors come in with a checklist or take a “big-picture” perspective?
- ◇ What is the perception of the internal audit function within the organization? Are they viewed as “police” or trusted advisors?
- **Seek out best practices.** Even though best practices for committee audits may be hard to find, it is important that the audit go beyond compliance with the committee’s charter and review of other committee documents and consider how its activities reflect good governance practices for the type of organization or committee. Reviewing best practices also can be helpful in determining what steps committees can take to improve their performance.
- **Build in opportunities for self-correction.** Consider conducting a “pre-audit” conversation for committees to let them know the types of issues that will be looked at during the audit, such as how the committee is functioning overall, how its meeting agendas are developed, whether it is following its charter and whether there is an appropriate level of dialogue during meetings. A pre-audit discussion can surface issues that committees can examine and address before the audit occurs. Using a structured annual agenda that covers all committee duties, ensuring that committee members receive meeting materials enough in advance to review and consider them; and maintaining a culture of open, candid dialogue between the board and management are additional steps board committees can take to be prepared for an audit. At Kaiser, one board committee had some ongoing time management challenges with its agenda. During the pre-audit conversation, the internal auditors mentioned that this was one thing they would be looking at during the audit. The committee corrected this issue in advance of the audit and continues to conduct its meetings more smoothly and effectively.

- **Determine how committee audits will be sequenced.** Kaiser focused on the governance committee first because of its responsibility for overall committee effectiveness and the need to gain its support for continuing the audit process. “This committee also was a good choice for us,” Overmyer says, “because it was a stable and well-developed committee with a straightforward charter and responsibilities.”

### Suggestions for Boards Considering Auditing Their Committees

1. Consider the maturity of the internal audit function and the board.
2. “Socialize” the audit idea.
3. Seek out best practices.
4. Build in opportunities for self-correction.
5. Determine how committee audits will be sequenced.
6. Identify audit triggers.
7. Communicate often.
8. Determine how findings will be delivered.

- **Identify audit triggers.** If a committee is operating well but wants an outside perspective on its role and function, an audit can be helpful. However, if a committee is just forming or is having difficulty fulfilling its role, an audit is not a substitute for expert counsel or facilitation. In determining how the internal audit function might be helpful, boards should consider the maturity of the committee. If the committee’s evolution is less mature, internal audit can be helpful in identifying where a committee might focus first to strengthen its own effectiveness. For example, internal audit might suggest that a committee revise its charter if it is unclear or too long or short to enable the committee to focus on the right scope or level of work.

- **Communicate often.** Make sure there is ongoing communication with the committee chair throughout the audit to ensure “no surprises” when the audit findings are delivered. Also conduct periodic check-ins with the corporate secretary or executive who supports the board and with key management staff who support the committee. These conversations can surface potential issues that can then be addressed before the audit concludes.
- **Determine how findings will be delivered.** At Kaiser, there is communication throughout the audit, and once it concludes, the committee and management who staff it receive the final results first. They learn about the issues the audit uncovered, recommendations to address them and the audit opinion. Auditors also discuss the committee’s strengths and give the committee chair the opportunity to comment on the audit process and findings. A formal report is then issued and is sent to the board chair, the committee and other key stakeholders. An audit report is also given to the board and the governance and audit committees.

As Kaiser’s board and management discovered, a rigorous, standards-based audit process that employs recognized best practices and that is conducted in an objective, independent, transparent and accountable manner pays multiple dividends. It assures board members that they are fulfilling their governance and fiduciary responsibilities in a compliant and accountable way and positions the internal audit function as a credible and useful resource for supporting and enhancing governance effectiveness.

*Note: This article expands on a description of Kaiser’s board committee internal audit process included in “Governance in Large Nonprofit Health Systems: Current Profile and Emerging Patterns” published in 2012 by the Commonwealth Center for Governance Studies, Lexington, Kentucky.*

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