Should the Full Board Approve the CEO's Compensation?

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Should the full board know and approve the salaries of top executives, or may it delegate this responsibility to a committee?

The short answer is yes. A fiduciary board is responsible for and should know the compensation of its top executives. The board may delegate the details of compensation plans, salaries, incentive awards, and contract terms to an executive compensation committee, but it must ultimately oversee the committee's work and review/approve its recommendations.

For better or worse, executive pay has become a high visibility issue. In some places, newspapers publish hospital CEOs' salaries using publicly available data from a hospital's own Form 990. Senator Charles Grassley is examining healthcare organizations' executive pay practices, and recently criticized the independence of hospitals' board compensation committees, their lax oversight of personal entertainment expenses, and the use of supplemental executive retirement plans (SERPs).

With hospitals' charitable tax status under scrutiny, it's time for boards to open a window on the work of their executive compensation committees. In this context, we offer the following advice:

1. **Independent executive compensation committee.** This committee should be composed of only independent directors. This excludes the CEO and other C-suite members, medical staff members, and directors who do business with the organization.
2. **Engagement.** The committee is not a rubber stamp—it must be informed and engaged, raising tough questions and exercising rigorous oversight. The full board should approve the committee's charter. The committee should become literate in government requirements and compensation trends, including IRS Section 4958.
3. **Independent advice.** This committee should choose an independent compensation consulting firm to provide education, advice, and comparability.
4. **Compensation philosophy and plan.** This committee should recommend to the board a compensation philosophy and incentive plan that provides a framework for base pay and incentives for the CEO and other senior executives. Without this context to educate the board, salary figures are orphan data that leave the board ill-equipped to assess whether compensation is reasonable and competitive with the market among comparable organizations.
5. **Report to the board.** The committee should educate the board on its work by means of a thorough report, including the annual compensation awards in the context of the board-approved ranges in the compensation plan. Most boards look to the CEO to recommend incentive increases for members of the senior team consistent with the compensation plan.
6. **Board approval.** The full board should review and approve the committee's recommendations. Except in rare circumstances, the board should not rehash or redo the committee's work. The full board should also approve the terms of the CEO's contract.

For some boards, this is business as usual—for others, it will be a difficult change. Greater transparency opens a cloistered process to the risks of inappropriate tinkering and breaches of confidentiality. Board education, clear policies, and rigorous enforcement of confidentiality can mitigate the risks. Gradual implementation may be appropriate.

We recognize some will disagree with our recommendations, but we believe a board of directors deserves information that will in short order be in the public domain, available to the press, and accessible to regulators and legislators. In an age of accountability and transparency, the board needs to know. ◆