



**RISK
MANAGEMENT
SERIES**

Developing Comprehensive Standards of Conduct

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Awash in headlines of corporate wrongdoing and revised earnings statements, nonprofit Board members fear that they may not be doing enough to oversee corporate compliance. Upper management wonders if there are sufficient mechanisms in place to detect fraud and worry if they actually detect it. Frontline employees worry they could lose their jobs if corporate wrongdoing is found.

The organization's Standards of Conduct (or Code of Conduct or Code of Ethics) has come to assume major importance as an indicator of the effectiveness of a compliance program. Both Sarbanes-Oxley (The American Competitiveness and Corporate Accountability Act of 2002) and the U.S. Sentencing Commission postulate that an effective compliance program begins with a Code of Conduct. Indeed, the U.S. Sentencing Commission amended the Sentencing Guidelines last fall to add to the definition of an effective compliance and ethics program not only the detection and prevention of criminal conduct, but also the promotion of an organizational culture that encourages **ethical conduct and a commitment to compliance with the law.**¹

That commitment may be reflected in the health center's Standards of Conduct. Standards of Conduct are a statement or an outline of the broad ethical principles that will govern the health center. The Standards serve as the "constitution." By conveying the specific legal and ethical duties and responsibilities that will guide Board members and employees, the Standards of Conduct are **a framework against which everyone in the organization can measure his or her business conduct**, and the health center can publicly comply with the law. If the health center lives by the tenets of its Standards of Conduct and communicates them to all levels, from the front-

¹ United States Sentencing Commission, Guidelines Manual, Sec. 8B2.1(a)(2) (November 2004).

line employee to the top executive and the Board, then implementation of a compliance program should be easier.

This Information Bulletin:

- ◆ Introduces the manner in which the Standards of Conduct can assist both Board members and employees **to act in the best interests of the health center** corporation at all times;
- ◆ Addresses the Standards of Conduct as a key feature of the health center's **corporate compliance program**; and,
- ◆ Describes specific elements recommended for a “**model**” **Standards of Conduct**, in order to assist health centers in developing their own comprehensive Standards.

BOARD MEMBER AND EMPLOYEE DUTIES

Board members and employees have different duties toward the corporation. An employee, on the other hand, is charged with fulfilling the duties of the position that is described in a position description. In return for being paid for the position, the employee owes a duty of loyalty to his or her employer.

Board Members' Duties

The Board members have a **fiduciary duty** because they are entrusted with the governance of the corporation and they agree to accept the trust placed in them by acting in the best interests of the corporation. Underpinning the fiduciary duty, a Board member has three specific duties owed to the corporation he or she oversees: the duty of care, the duty of loyalty, and the duty of obedience.

The Duty of Care

The Duty of Care underlies the fiduciary duty – that is, the duty to act in good faith, using the degree of care a customarily careful person would use in making a decision. In exercising the duty of care, for example, an ordinarily careful person would conduct a reasonable inquiry into the finances and into the effectiveness of the compliance program. Thus, a Board member should ask for regular reporting on the compliance program, with the same degree of diligence as he or she asks questions about the financial reports.

The Duty of Loyalty

A corollary to the duty of care is the duty of loyalty, which is the principle that a Board member must have undivided allegiance to the health center rather than making decisions based on one's personal interests. In order to help Board members fulfill

this duty, conflict of interest standards are key.²

The Duty of Obedience

The third duty, the duty of obedience, requires each Board member to observe and be faithful to the organizational mission of the health center when making decisions for the health center.

Employees' Duties

While not bound by fiduciary duties, employees³ nevertheless also owe a duty of loyalty to their employer. The Standards of Conduct should require them to act in their employer's (*i.e.*, the health center) best interests.

Volunteer Staff

Volunteer staff cannot be bound to Standards of Conduct in the same way as employees since they do not receive pay for their work. However, the health center can require volunteers to adhere to the Standards of Conduct if they want to continue volunteering for the health center or one of its programs. Volunteers are not in decision-making positions where a conflict of interest might emerge, nor do they handle billing or coding where fraudulent or false claims could arise. But insofar as a standard might apply to the volun-

2 If a health center Board member (or his or her immediate family member) owns or is employed by an organization that does business, or competes, with the health center, conflicts of interest may arise, and need to be managed per the health center's Standards of Conduct.

3 The Standards of Conduct should also apply to contracted personnel by the terms of the contract itself.

teer's role, such as the duty to maintain strict confidentiality of all patient records, then it should be part of their training as volunteers and emphasized as part of the health center's code of conduct.

INTRODUCTION TO STANDARDS OF CONDUCT

The Standards of Conduct should not be viewed as expressing lofty and unachievable goals; rather, they should be:

- ◆ **Realistic** and tailored to fit the organization to which they apply;
- ◆ **Set high** to articulate a set of ethical practices that will guide the Board, the management team, and the staff of a health center, particularly with a health center that occupies a role of health care provider, employer, and community health resource; and
- ◆ **Used as a guide** for all the health center's employees – from frontline up to senior management, as well as contract personnel.

Effective Corporate Compliance

Developing Standards of Conduct to which the entire organization subscribes is one of the cornerstones of a corporate compliance program. The idea of corporate compliance arises from the Guidelines published by the United States Sentencing Commission which, in

the 1991 version, provided guidelines for judges to use when sentencing criminal defendants, including organizations that were convicted of felonies as a result of the actions of their agents and employees. If a corporation created an effective compliance program that would detect violations of the law and prevent offenses such as the one in which the corporation was charged, then the sentence could be mitigated and fines reduced.⁴ Since a corporation acts through its Board and its employees, in order for a compliance program to have any effect, it must involve every person in the organization. Furthermore, it is the Standards of Conduct that sets the tone for a culture of compliance.

Procurement Standards

Maintain Written Standards of Conduct

As a compliance matter, the federal government's procurement standards require grant recipients (including Section 330-funded health centers) to maintain written Standards of Conduct that govern Board members, employees and agents engaged in the selection, award and administration of any contract.⁵ The procurement standards direct grantees to avoid conflicts of interest in decision-making

related to procurements by assuring that:

No employee, officer [Board member for health centers], or agent shall participate in the selection, award, or administration of a contract supported by federal funds if a real or apparent conflict of interest would be involved. Such a conflict would arise when the employee, officer, agent, or any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of the parties indicated herein, has a financial or other interest in the firm selected for an award.

See 45 C.F.R. § 74.42. Similarly, the IRS deems a conflict of interest policy as one of the key factors demonstrating that a tax-exempt health care organization benefits the community as a whole rather than private interests.⁶

Do Not Solicit or Accept Gratuities

The second requirement of the procurement standards states that the grant recipient's Standards of Conduct must provide that officers, employees, and agents cannot solicit or accept gratuities, favors or anything of monetary value from contractors or parties to sub-agreements. This is another way of saying that every Board member, employee and agent owes the health center the highest duty of loyalty.

4 18 U.S.C. § 18 dealt with the guidelines for organizations who were convicted of felonies and Class A Misdemeanors. The Sentencing Guidelines established seven elements of a compliance program, the first being standards and procedures "reasonably capable of reducing the prospect of criminal conduct." 18 U.S.C. § 8A1.2, App. Note 3(k).

5 Uniform Administrative Requirements for Awards and Sub-Awards to Institutions of Higher Education, Hospitals, Other Nonprofit Organizations, and Commercial Organizations, 45 C.F.R. § 74.42

6 2000 Exempt Organizations, CPE Text, Revised Conflict of Interest Policy.

Establish Disciplinary Action

The final requirement of the procurement rules states that the Standards of Conduct must establish disciplinary action that will be taken vis-a-vis officers, employees, or agents of grantees who violate the Standards of Conduct.

The Federal regulations establishing the standards for health center governing Boards themselves establish a standard of conduct by prohibiting any member of the Board or the member's immediate family member from being an employee of the health center. See 42 C.F.R. § 51c.304. Although the regulations do not prohibit family relationships between and among Board members, many health centers choose to prohibit a Board member's family member from serving as another member of the governing Board as part of a broad anti-nepotism policy in the Standards of Conduct.

ELEMENTS OF MODEL STANDARDS OF CONDUCT

A recommended model for Standards of Conduct contains eight areas sections that address conduct and which are described in more detail below. In drafting and securing approval of the Standards, it is important to **include Board members and senior staff, as well as rank and file employees**, so that there is buy-in at all levels of the health center. Everyone must understand that the Standards are central to the lawful and ethical conduct of business at the health center.

Elements of Model Standards of Conduct

1. Statement of Purpose
2. Statement of General Responsibilities
3. Standards for Managing a Conflict of Interest
4. Procurement Standards
5. Confidential Information
6. Political Activities and Lobbying
7. Reporting Violations and Disciplinary or Corrective Action
8. Periodic Compliance Reviews

Statement of Purpose

Describes the reason for establishing the Standards of Conduct, namely, to:

- ◆ Preserve the integrity of decision-making;
- ◆ Promote appropriate conduct by Board members, employees and agents; and
- ◆ Ensure that they will act in the best interest of the organization and not use their positions for personal gain.

A related purpose is to require everyone associated with the health center to preserve the confidentiality of the health centers' health and business information.

Statement of General Responsibilities

A policy statement to:

- ◆ Acknowledge the importance of maintaining the health center's reputation for integrity by adhering to federal, state, and local laws, and fulfilling contractual

obligations;

- ◆ Underscore the individual responsibility of each Board member, officer, employee, and contractor to comply with the Standards; and
- ◆ Ensure that individuals who report to supervisors and contractors who supervisors oversee must also adhere to the Standards.

Standards for Managing a Conflict of Interest

A description of areas in which the Standards of Conduct insure that conflicts of interest are avoided.

Definition of Conflict of Interest

A conflict of interest arises when someone's interest actually or potentially competes with the best interests of the health center. The interest involved may be any of the following, individually or in combination:

- ◆ Business relationship (*e.g.*, an actual or forthcoming contractu-

al relationship with another person or entity).

- ◆ Financial relationship (*e.g.*, a controlling ownership interest or an investment interest).
- ◆ Fiduciary relationship (*e.g.*, serving on the Board of an entity with which the health center does business or is about to enter into such a relationship or competes.)
- ◆ Personal relationship (*e.g.*, family, friendship or other personal relationship with someone who is in a position to make or influence decisions of another entity or an individual with which a transaction is contemplated).

Please note that an investment interest in a publicly traded company can be defined as not being a conflict if the individual's investment or ownership interest is less than one percent (1%) of the company's shares.

Prohibition

No one can participate in the selection, award, or administration of a federally-funded contract if there is a real or an apparent conflict of interest involved.

Disclosure

The steps to managing a conflict of interest are:

- ◆ Provide a means for disclosure;
- ◆ Offer a means to assess and determine whether a conflict truly exists; and if one does,
- ◆ Take action with respect to the conflict.

Disclosure can be accomplished by requiring annual reporting on a form that lists a person's financial, business, and Board interests. In addition, a Board member, employee, or agent is obligated to disclose a

conflict if a matter comes up where a person recognizes that he or she has a personal or financial interest that has been overlooked or was not apparent until the transaction was presented for a decision. The Board member would disclose the conflict to the Chairman of the Board, while an employee would disclose to the health center's Chief Executive Officer (CEO).

Board members should disclose their interests at three different points in their tenure on the Board: (1) prior to their election or appointment, (2) annually thereafter, and (3) whenever a particular conflict arises.

Determining Whether a Conflict Exists

Once the conflict has been disclosed, it is up to the Board, in the case of a director, or the CEO, in the case of an employee, to determine whether there is a real or apparent conflict of interest.

- ◆ Permit the conflicted person to make a presentation to the Board or to the CEO about why he or she believes it is not a conflict. Relevant factors might include:
 - The proximity of the person to the decision-making authority of the other entity;
 - The amount of the financial interest or investment (*i.e.*, is it truly *de minimis*?); and
 - The degree to which the person might benefit personally if a particular transaction were approved.
- ◆ Require that the conflicted person leave the meeting after presenting his or her side.
- ◆ Know that in certain situations, such as when a person who is in a decision-making position at another organization with which

a transaction is proposed, as well as serving in a similar role at the health center, a conflict of interest should be presumed to exist.

Procedures to Address Conflict

The CEO or chairman of the Board then determines if there are alternatives to a transaction or if the conflict can be managed by, for example, removing the person from the discussion and vote on the transaction.

- ◆ If the conflict involves a procurement, the procurement policy of the health center should be followed.
- ◆ If there is no alternative to the proposed transaction or vendor, then it would be up to the Board or CEO to determine whether the transaction should still be concluded in the best interests of the health center.
- ◆ It could be that a person's interest causes a conflict so pervasive that the person would have to remove himself or herself from the Board.
- ◆ Some health centers may decide as a matter of policy not to do business with anyone associated with a Board member, where other health centers may choose to decide this on a case-by-case basis, as long as the decision is made in the best interests of the health center and not of the individual.
- ◆ If the Standards of Conduct allow for procurement relationships involving Board members (or family members or business associates of Board members) as the vendor, the member of the Board who is conflicted must not participate in the discussions or vote regarding his or her selection, and the procurement

must meet procurement standards in being a fair, objective, arm's-length transaction (and, preferably, the result of competitive bidding).

Recordkeeping

The minutes of a Board meeting or a memorandum to the file by the CEO should be used to document conflicts of interest and management of the conflicts. At a Board meeting, any disclosed conflict of interest should be described, along with the decision as to whether it was deemed a conflict. The minutes should record:

- ◆ The names of the participants,
- ◆ The content of the discussion,
- ◆ The identity of those who voted and those who recused themselves,
- ◆ The nature of the alternatives considered, and
- ◆ The vote on the transaction with the identity of those who voted for and those who voted against the transaction.

Compensation

Board members should not be compensated for their services as Board members either in actual cash or indirectly through substantial gifts or favors. A Board member may, however, be compensated for actual expenses associated with his or her service, such as travel expenses to an educational seminar regarding health center governance. Reimbursement for expenses does not include reimbursement of any family member's expenses.

Similarly, if the CEO receives income from an outside source as a

consultant or a part-time employee of another entity, he or she must disclose that to the chair of the Board so that the chair can determine whether that activity conflicts with the health center activity.

Employees who wish to have outside employment to supplement income should disclose that to the CEO, so that the CEO can determine whether the outside employment presents a conflict of interest.

Gifts and Gratuities

This is another significant area in which the Standards of Conduct further insure that the duty of loyalty is fulfilled and conflicts of interest are avoided. As mentioned above, it is also a key element of the Code of Conduct under procurement rules. While the Board may decide as a matter of policy that non-cash gifts of nominal value such as pens, calendars and mugs are permitted, no cash or cash equivalents from those who do business with the health center should be permitted. Personal gifts, liquor, social entertaining, sports events tickets, gift cards, and the like are also prohibited. While it may be true that a ticket to a baseball game given by a contractor to a health center will not influence a decision, it gives an appearance of a conflict of interest.

Any contractor who offers a bribe and any Board member or employee who accepts a bribe in return for funding by, or a contract from, the health center should be removed from the Board, terminated, respectively, and the contract voided.

Procurement Standards

The health center should also include as part of its Standards a statement referencing its procurement policy and the intention to conduct procurement in a manner that is, to the maximum extent, open, practical, and encourages free competition, as well as avoiding conflicts of interest and non-competitive practices among contractors so that the best vendor – in terms of price, quality, and efficiency – is chosen.

Within the health center itself, conflicts of interest in the form of non-competitive practices should be scrupulously avoided. For example, the contractor who wants to bid on work from the health center should not draft the contract specifications or the request for proposal.

Confidential Information

Board members and employees are likely to acquire confidential protected health information as well as proprietary business information by virtue of their positions with the health center. In all cases, the Standards of Conduct should clearly articulate the importance of maintaining the confidentiality of health center information. Board members, administrators, and frontline employees all have to exercise care not to make an inadvertent disclosure of this confidential information, whether it is a lawsuit that has been brought against the health center or a new affiliation. Both the duty of care and the duty of loyalty require that the health center's busi-

ness strategies, risk management issues, quality improvement information, employment information, and patient information be kept confidential. One way of reinforcing the duty is requiring all employees and Board members to sign a confidentiality statement.

Political Activities and Lobbying

In order to maintain their nonprofit status, health centers, as corporate entities, cannot engage in political campaigns or contribute to political campaigns, nor may campaign contributions be asked of individuals during work. Board members, officers, employees, and contractors should not be permitted to do any kind of fundraising or soliciting for a political party or candidate using the health center's name, facilities, equipment, supplies, or any other health center resources.

Lobbying activities (*i.e.*, activities that support or oppose legislation) conducted by tax-exempt organizations such as health centers are allowed, so long as the activity is insubstantial in relation to all of the center's activities. However, no federal grant money may be used to support such lobbying activities.

Reporting Violations and Disciplinary or Corrective Action

The Standards of Conduct should set forth the consequences of violations of the Standards, as well as failing to disclose an interest, as well

as to whom to report a violation and the consequences of such reporting. If someone has reason to believe that another person has not disclosed a conflict of interest, then the person should be given an opportunity to explain the failure to disclose. If it is a Board member or the CEO, then the report of a violation would be to the Board chairman who in turn may seek assistance from the Board as to the appropriate sanction or corrective action (which could include removal from the Board position).

If it is an employee who violated the Standards, then the report would be made to the employee's supervisor or to the compliance officer. Disciplinary action may include a warning, removal from playing any part in the negotiation or administration of any contracts or grants, or a suspension or termination from employment, depending on the circumstances, such as whether the failure can be deemed to be inadvertent or intentional.

Upon appointment to the Board or hiring into a management position, an individual should be asked to sign an acknowledgement and agreement to adhere to the Standards of Conduct, along with requiring the disclosure of any then-current interests, and a confidentiality agreement, both of which reinforce the importance of the pledge. If a Board member violates these Standards, he or she could be subject to a warning or removal from the Board, depending on the severity of the violation. There could also be legal penalties that result.

Periodic Compliance Reviews

Periodic reviews of high-risk areas within the organization should be conducted to assure that the health center remains compliant with, among other things, the Standards of Conduct. An example of a high-risk area, according to the Office of Inspector General, is procurements. Accordingly, the health center might verify annually that all relationships with providers and vendors are in writing with the contractor and that individuals or entities are paid fair market value (documented with other bids and/or comparability data) for the services they render. If any contractor has a relationship with the health center that has conflict of interest implications, an assessment might be made as to whether there is documentation that the Standards of Conduct were followed.

CONCLUSION

In conclusion, the Standards of Conduct are a firm foundation on which to rest a corporate compliance program. In this post-Enron era, neither the Board nor the CEO should hesitate to hold the health center's feet to the fire to adhere to principled conduct that the community now expects of every corporation. But the Standards are only as good as each Board member and each employee's understanding of and compliance with them. Each Board member and each employee is responsible for setting an example of adherence to ethical conduct.



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