Big Bucks or Big To Do About Nothing: CEO Compensation in the Spotlight

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Published stories about salaries paid to nonprofit CEOs often include scathing comments from individuals who take offense at what they regard as too-rich pay for charity leaders. And it’s not only donors, journalists and casual onlookers who take offense to what they perceive to be exorbitant pay. Recently several state governments have issued regulations that put a ceiling on the amount of government contract funds that may be used to pay executive compensation. Whether you’re on the sidelines with “no opinion” or in the thick of things as a highly-compensated employee at a nonprofit, the cauldron of controversy about highly paid sector leaders shows no sign of cooling down.

Boards asked to defend their decisions about CEO pay often respond that the talent and skills required to run a successful nonprofit enterprise is no less than the talent and skills required to run a successful for-profit. And unlike their nonprofit counterparts, for-profit CEOs are often eligible for stock options and perks. Many nonprofit boards have concluded that competitive pay is necessary to entice high-performing candidates to accept and remain in high pressure jobs. While it is true that some great nonprofit CEOs work for pennies, the desire to offer competitive compensation is a worthy aspiration on the part of a board.

In the end, CEO compensation is a gray area. Only the board can decide: how much is appropriate? The bottom line lesson for boards today is that both the outcome and the process are important when it comes to determining the pay rate for a nonprofit CEO. To ensure that your nonprofit is in the strongest possible position to both minimize the risk of negative scrutiny and respond if your actions draw the spotlight, remember to:

- Follow IRS guidelines
- Do your research
- Don’t get ahead of yourself
- Take note
- Prepare to answer questions

Follow IRS Guidelines — The IRS permits nonprofit boards to pay their CEOs a “market rate,” generally determined by researching what executives in similar positions would earn at organizations of similar size, location and/or mission. A board may consider pay rates in the for-profit world when determining market rate, as long as the position requirements and organizational factors are comparable. Keep in mind that although the

IRS warns that compensation and benefits must be ‘efair and reasonable,’ it does not provide a formula or resources to determine fairness.

Do Your Research — Conduct research to find out what CEOs are being paid at similar or comparable organizations. A published salary survey might be a good starting point, but make sure you understand the scope of the survey before relying on its data. For example, a survey of CEO compensation among social services agencies is likely to reveal lower average pay than a survey of CEO’s of trade associations or hospitals. If you can’t find a published survey whose participants are truly similar organizations, make a list of comparable nonprofits and either research their CEO’s compensation on published Form 990s at www.guidestar.org, or contact them directly to ask about the possibility of exchanging CEO compensation data. Keep in mind that Form 990 salary data won’t reveal what the CEO is being paid for the current year.

Don’t Get Ahead of Yourself — Always approve executive compensation in advance of disbursement, and make certain you have surfaced and addressed any conflicts of interest for anyone participating in compensation assessment or disbursement.

Take Note — Always take time to document the steps taken to determine and approve CEO compensation. And remember that to earn the “rebuttable presumption of reasonableness” from the IRS your documentation should include:

- the terms of the transaction and the date of its approval,
- the members of the authorized body present during the debate and vote on the transaction,
- the comparability data obtained and relied upon, and
- the whether members of the authorized body had a conflict of interest and how that was handled.

Prepare to Answer Questions — Any nonprofit that pays its CEO a handsome salary faces the risk of donor or stakeholder wrath. The fact that someone may disapprove of your compensation decision shouldn’t dissuade the board from paying what it believes is a fair and appropriate salary. But acknowledging this risk is essential. Before you receive an angry phone call, email or tweet, ask:

- Is the process we used in setting CEO compensation described accurately on our Form 990?
- Does every member of the Board know about the process as well as the result?
- If there were special considerations in setting salary (e.g., the nonprofit’s requirement that the CEO also be a licensed attorney or doctor), have those considerations been documented?
- Do we have a statement ready to share that describes our process in greater detail?
- Are there any aspects of the current CEO’s compensation that make us uncomfortable? If yes, what can we do to get comfortable before inquiring minds “want to know”?

The mission of your nonprofit is too important for a whimsical approach to setting executive pay. When too little attention is paid to the process for determining what constitutes fair compensation, the board saves time in the short term at the expense of a potentially ugly, time-consuming and costly query down the road. The bottom line is that every board should acknowledge its responsibility for executive compensation as key to attracting and retaining qualified leaders. By exercising discipline in determining executive pay and following the tips outlined in this article, you’re not only reducing the risk of negative scrutiny, you are modeling a commitment to risk awareness and thoughtful decision-making for the entire organization.

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