CS&L CPAs

Protecting your Non-Profit from Executive Compensation Scrutiny

Tips for effectively determining and reporting executive compensation

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Nonprofit executives must manage multi-million dollar operations while staying focused on the organization's mission, population, and growth plan. Organizations are expected to pay executives fair and reasonable compensation, but there is no standard formula or model to calculate the "right" level of compensation.

Introduction

Far too often, we hear news of not-for-profit (NFP) executives receiving outrageous salaries, excessive benefits, unreasonable perks, and more, that seem contrary to the organization's mission and pose a threat to the perceived image of the organization.

Many NFPs are feeling the stress of reporting high CEO salaries due to complex IRS regulations and reporting requirements, as well as responding to the public's perception of what constitutes a reasonable compensation amount. Donors often express their discontent with the level of CEO salaries reported; however, the majority of NFP CEOs cannot afford to work solely due to their altruistic drive. Paying too much or too little to leadership are both red flags to donors and the IRS, which is why careful consideration and research must be performed in advance of the compensation offer. Alternatively, donors will be skeptical of an organization that reports zero CEO compensation, so it is important to fully disclose all public information to accurately present the organization.

CS&L CPAs is experienced in directing compensation discussions with NFP Compensation Committees to develop offerings that meet IRS regulations. This whitepaper will summarize the significant issue of excessive executive compensation, the risks involved with failing to comply with IRS regulations, how to protect your organization and Board Members from IRS scrutiny, and tips for determining an appropriate level of executive compensation.

Reacting to Public Perspective

In the for-profit world, if a company is doing well under the leadership of an effective CEO, the CEO is usually well compensated for the efforts he or she has contributed. On the other hand, if the company is failing and the CEO is paid below average, there may be a correlation between the expertise of the leader and the lack of success of the company. One would assume that the same idea would hold true in the non-profit sector, but a publicly funded NFP organization may have trouble justifying high salaries when donations are expected to directly support the cause. The average CEO salary varies from organization to organization based on mission type, size, and geographical location.

Unfortunately due to the recent actions of a few non-profits, this is not always the case and the IRS is cracking down on those NFP organizations that are excessively over-compensating their leadership.

Consequences of Excessive Wages

Non-profit organizations that are found to be providing unreasonable wages or benefits to their executives are at risk of losing their tax-exempt status or being fined for the violation. Intermediate sanctions are addressed in IRC 4958. This section allows the IRS to impose a tax on the executive as well as the board members of a not-for-profit (specifically a 501(c) (3) or (4)) in any instance where it deems there is an excess benefit transaction, such as with excess compensation. The tax for the executive is 25% of the excess benefit. If the executive does not make restitution within the period, the amount automatically jumps to 200%. Managers participating in the decision are taxed at the lesser of $20,000 or 10% of the excess benefit.

The loss of goodwill for the organization, as well as causing disgruntled feelings among NFP staff, donors, and the public, are all intangible outcomes of excessive NFP executive compensation, should that information be negatively publicized via the media or shared within social circles.

Protecting Against IRS & Public Scrutiny

Board members have a fiduciary responsibility to ensure that they have approved reasonable and not excessive compensation. To protect your non-profit and board from IRS intermediate sanctions, a NFP organization should take advantage of what the IRS refers to as "rebuttable presumption." This places the burden of proof on the IRS to show that the compensation was unreasonable.

To obtain a rebuttable presumption of reasonableness, ***three steps are recommended related to the review and approval of executive compensation:***

1. There should be an annual review by an independent body *(a compensation committee or executive committee)*
2. Comparable data should be used
3. There should be concurrent and adequate documentation of the board's consideration in the minutes

A recommended approach is to assemble a Compensation Committee that can administer a step-by-step process for determining executive compensation in advance. The determination process must include comparability studies comprised of data from similarly qualified, functionally comparable and similarly situated geographical areas in order to be comparable. Some high salaries are justified when utilizing the comparability data that the IRS requires for defining compensation level, but this must be properly documented throughout the compensation determination process. It is important to remember that executive compensation includes salary and benefits, ranging from insurance, transportation vehicles, housing allowances and other fringe benefits that may apply.

To obtain the necessary comparability data, NFP organizations should utilize independent external compensation studies or surveys, which would meet the requirement of providing the IRS with solid data. The decision making process must be documented at the time of discussion and approval to provide the most accurate reporting - this is usually done through documenting the meeting minutes at the Compensation or Board Meeting. Additionally, the Board should ensure that the 990 has disclosed all of the required information regarding the non-profit's highly compensated individuals.

NFP organizations should also assess their current risk status by evaluating whether their current compensation policy meets the IRS requirements for rebuttable presumption. Additionally, they should consider whether any conflicts of interest potentially exist that may increase their risk.

What to do if your Organizationis at Risk

Executive Compensation review continues to be a priority of the IRS and increased scrutiny is inevitable. To ensure your organization is accurately reporting all financial information and compensating your leadership fairly, you should consider contacting your CPA or other advisor to discuss your current compensation policy. Your policy should be in writing. Consideration must be given to who will be part of the committee, including determination as to whether any conflicts of interest exist. A strict conflict of interest policy should be established to ensure no financial transactions will affect any affiliated individuals.

Most importantly, the committee should be educated in the process of approving executive compensation; including the risks associated with excessive compensation and the potential liability to the executive and committee members, should the policy not be appropriately followed and documented.

CS&L CPAs can help educate your organization and team members by meeting with your Board to discuss the pitfalls and opportunities of establishing executive compensation. We can provide the tools for a successful process and assist you as you plan for your organization's future.

Resources for Comparability Data

Charity Navigator's ***CEO Compensation Study***
www.charitynavigator.org

GuideStar ***Nonprofit Compensation Report***
www.guidestar.org

The Chronicle's ***Annual Survey on Executive Compensation & Benefits***
www.philanthropy.com

Highest Paid Non-Profit Executives*

1. Laurence Hoagland Jr., *CIO,* ***William and Flora Hewlett Foundation*** **-** $2.5 Million
2. John Seffrin, *CEO,* ***American Cancer Society*** **-** $2.1 Million
3. Roxanne Spillett, *President,* ***Boys & Girls Clubs of America*** - $1.8 Million
4. Reynold Levy, *President,* ***Lincoln Center for the Performing Arts*** - $1.4 Million
5. Placido Domingo, General Director, Los Angeles Opera - $1.35 Million

*According to data obtained from the *Chronicle of Philanthropy*, excluding executives at colleges and hospitals, as posted on *www.TheFiscalTimes.com*.

About CS&L CPAs

CS&L CPAs is a certified public accounting firm that has been serving Sarasota and Manatee Counties since 1954. The firm is located in Southwest Florida, with two offices in Bradenton and Sarasota. We provide accounting, taxation, auditing and consulting services to individuals, businesses and organizations. Our not-for-profit team is experienced in the challenges of NFP organizations, and can provide financial and compliance audits, preparation of Form 990, outsourced CFO services, compliance with OMB Circular A-133, Compliance with the Florida Single Audit Act, and more.

CS&L CPAs has been named a 2013 **"Best Company to Work for in Florida"** by *Florida Trend Magazine*, and has been named a **"Best Place to Work in Tampa Bay"** by the *Tampa Bay Business Journal* for 5 consecutive years. ***Our mission is to understand your unique needs and create exceptional solutions.***

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About the Author

Susan Thompson, CPA, has over 22 years of experience in a variety of tax and audit services. She specializes in not-for-profit organizations, foundations, individuals and business taxation. She joined CS&L CPAs in 1991 and currently serves the Bradenton, Sarasota, Tampa and Ocala areas. Outside of work, Susan is an active member of many community organizations and finds it personally fulfilling to support the non-profit or volunteer organizations related to human, children's and health services. As the former President of The Junior League of Tampa, Susan has championed many not-for-profit initiatives and witnessed the positive impact these organizations have made in the community. She has previously served as Treasurer of the Pediatric Cancer Foundation and was a prior Co-Chair for the Key to the Cure fundraising event.

She is a current member of the American Institute of Certified Public Accountants (AICPA), the Florida Institute of Certified Public Accountants (FICPA) and participates as a Board Member and parent volunteer for her childrens' schools and foundation. She received her undergraduate degree in Accounting from Emory University followed by a Master degree in Accounting from the University of Florida.

Areas of Expertise

- Individual and Corporate Taxation
- Real Estate
- Construction
- Not-for-Profit Organizations
- Foundations
- LLC's & S Corporations

Community Involvement

- Junior League of Tampa - *Current: Sustaining Member*
  Past: President, President Elect, Community Vice President, Treasurer
- Robinson High School Foundation - *Current Treasurer*
- Dale Mabry Elementary PTA - *Past President*
- Coleman Middle School PTA - *Current Board Member, Past Treasurer*

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