

Will Your Nonprofit's Executive Compensation Withstand Scrutiny by the IRS, Public and Media?

Overview Part I

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Wednesday Webinars
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**McCARTER
& ENGLISH**
ATTORNEYS AT LAW

Overview of Webinar

- Executive Compensation, Good Governance and Design (Lindalee Lawrence)
- Accountability and Good Governance (Rick Lucash)

Webinar Housekeeping

- Join us again on February 24, for Part II covering case studies, examples and frequently asked questions.
- If you have questions, please submit them in writing using the Question Box. We will answer them as we go along, if possible, or at the end.

Who is in our Audience?

Polls

- Industry Sector
- Role in Organization

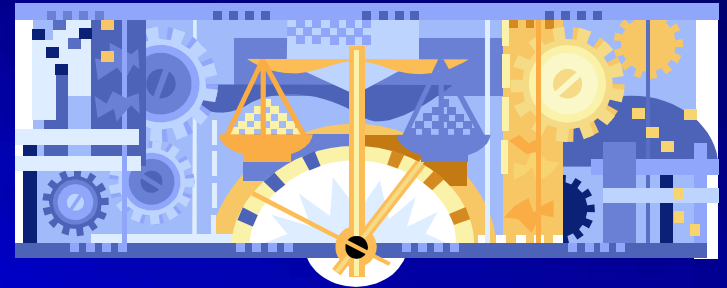
Why Do We Care?



- **Personal Liability** for Executives and Board Members
- IRS Survey of Colleges and Universities – 40 being audited
- IRS Studied Nonprofit Hospitals starting 2006
- IRS examined compliance by 2000 Nonprofits starting 2004
- Public Attention on Executive Compensation in public companies has affected nonprofit sectors
- Local Press Focuses on Local Nonprofits
- Attraction, retention and motivation of needed talent

Executive Compensation, Good Governance and Design

- Best Practices –
IRS Focus on Governance
- Comparability Data
- Aligning Strategies and
Rewards to Attract and
Retain Talent
- Elements of Compensation
- Pay in the New Economy



Publicly reported approaches to establishing CEO compensation

- ✔ Compensation committee?
- ✔ Independent compensation consultant?
- ✔ Forms 990 of other organizations?
- ✔ Written employment contract?
- ✔ Compensation survey or study?
- ✔ Process includes “review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision”? (Are you in the safe harbor?)

Comparability Data

Executive Market Factors

Factors Affecting Base Salary

- ➔ Organization Size
- ➔ Competitive Market
- ➔ Geographic Region



Performance

Scope of Work

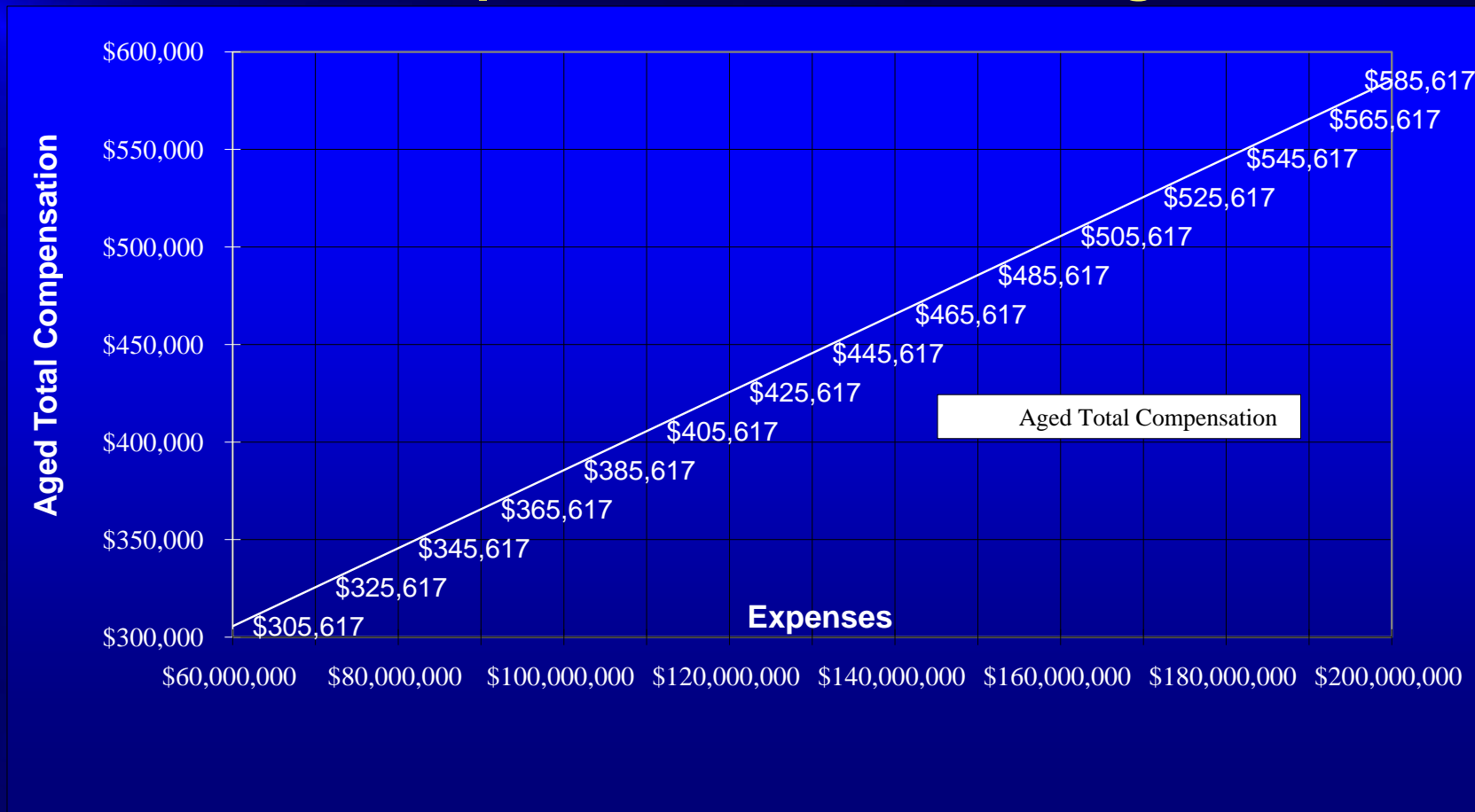
Organizational Dynamics

Example of Selected Forms 990

- American Cancer Society inc (National Home Office)
- American Lung Association of New York State, Inc.
- Center for Disability Services, Inc.
- Cerebral Palsy of Massachusetts, Inc.
- Cerebral Palsy of Westchester Inc
- Community Living Services, Inc.
- Cystic Fibrosis Foundation - Headquarters
- Developmental Disabilities Institute Inc
- Easter Seals, Inc.
- Elwyn
- Federation Employment and Guidance Service Inc
- HeartShare Human Services of New York
- Interagency Council of Mental Retardation & Developmental Disabilities Agencies
- Jawonio Inc
- Lifespire, Inc.
- National Multiple Sclerosis Society
- New York State Associations of Community and Residential Agencies, Inc.
- NYSARC, Inc. Montgomery County Chapter
- NYSARC, Inc. New York City Chapter
- People Inc.
- SCO Family of Services (Formerly St. Christopher-Ottillie)
- The Jewish Guild for the Blind
- The Susan G. Komen Breast Cancer Foundation Inc
- United Cerebral Palsy and Handicapped Persons Assoc of the Utica Area Inc
- United Cerebral Palsy Association of Greater Suffolk Inc
- United Cerebral Palsy Association of Nassau County Inc
- United Cerebral Palsy Associations of New York State Inc.
- United Cerebral Palsy Associations, Inc.
- United Cerebral Palsy of NYC, Inc.
- United Cerebral Palsy of Queens
- United Jewish Appeal - Federation of Jewish Philanthropies of New York Inc
- Young Adult Institute, Inc.

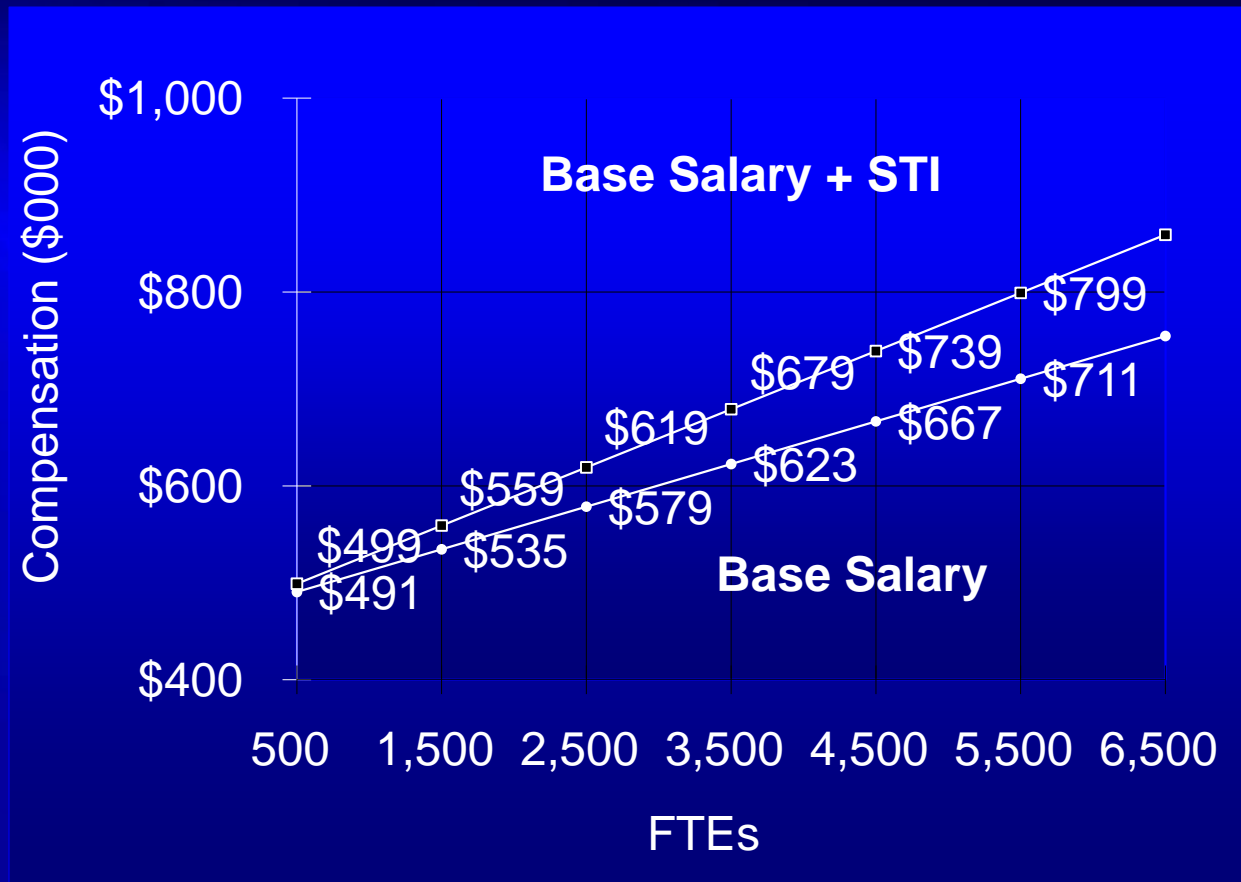
Using IRS Form 990 Comparability Data

Example Regression Analysis of IRS Form 990 CEO Total Compensation for Similar Organizations



Comparability Data

Regression Analysis of CEO Pay



CFO, Top HR

Statistical Position in Market



Remember to Focus on Your Compensation Objectives

- Target Talent
- Attract, Retain, Reward
- Compensate Based on Business Needs and Strategic Objectives
- Assure Compliance and Good Governance

Design

Aligning Strategies and Rewards

Compensation Design Dynamics



Elements of Pay

- Base Salary
- Short-term Incentives
- Long-term Incentives
- Deferred Compensation/Capital Accumulation (457(b), 457(f), split dollar, trusts, Professional Roth)
- Perquisites (contract, severance, auto)
- Non-monetary



Deferred Compensation

Important, costly, complex, disadvantageous

- 457(b): \$16,500, non-qualified deferred, execs
- 457(f): No limit, substantial risk of forfeiture and 409A
- 457(e): Not a deferred plan, bona fide severance pay plan
- Life insurance options: Grandfathered/ new Split Dollar

Pay in the New Economy

Media Conversations

- National Media: Modern Healthcare, Chronicle of Higher Ed, Chronicle of Philanthropy
- IRS Form 990 shows old economy pay
- Local Media: Are they tone deaf?
- Response: For high performer, Form 990 is questioned, then issue fades. For large complex organizations, can you get talent for less?



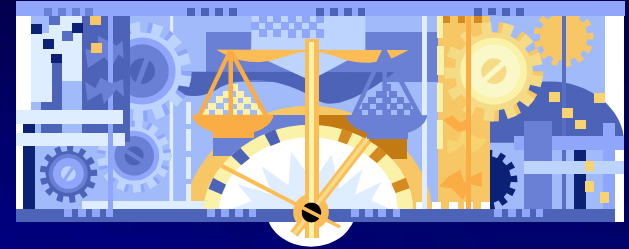
Pay in the New Economy

Organization Practices

- ★ Focus on performance, stars, engagement
- ★ Profit-sharing and gainsharing
- ★ Variable pay recovery
- ★ Executive Incentives – Try a new word

Accountability and Good Governance

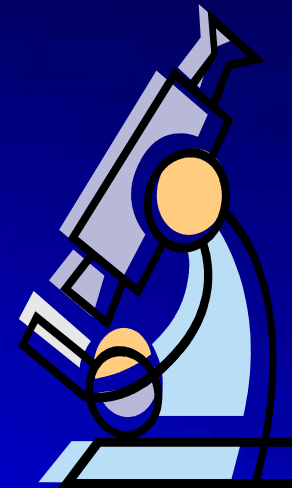
- IRC Section 409A
- Public Availability of Form 990 and **NEW** Disclosures
- Intermediate Sanctions
 - Excess benefit transactions to Disqualified Persons
 - Rebuttable presumption of reasonableness
 - Reasonable compensation



IRC Section 409A

- Rules on “Deferred” Compensation
 - If not in compliance, all amounts will be *currently* included in income
- Broad coverage
 - Nonqualified plans in general
 - Bonuses, severance
- Final deadline for compliance was 12/31/08
- But IRS Procedures allow for correcting certain mistakes in documents and/or plan operation

- Puts compensation “front and center” in Tax Year 2008
- New Schedule J focuses on:
 - W-2 income, not FY
 - Enumerated perks (e.g. first class air; club dues; housing)
 - Severance
 - Deferred compensation
 - Equity and other elements
- Policy questions – policies not mandatory but will their absence be notable on the Form 990?



Approaches to establishing CEO compensation

- Compensation Committee
- Independent Compensation Consultant
- Form 990 of Other Organizations
- Written Employment Contract
- Compensation Survey or Study
- Approval by the Board or Compensation Committee



- Written policy regarding payment or reimbursement or provision of specified expenses. Does the organization have a written conflict of interest policy?
- Officers, directors or trustees, and key employees required to disclose annually interests that could give rise to conflicts and regularly and consistently monitor and enforce compliance?
- Copy of Form 990 provided governing body before it is filed?
- Process includes "review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision" ?
- Compensation payments or accruals contingent upon the revenues or net earnings? Any other form of non-fixed payment?
- Board member and family member direct or indirect business relationship?

IRS Intermediate Sanctions

Why Do We Care?

- Penalty (“Excise”) taxes on the “excess”
- *Personal* liability
- 25% tax on the *recipient*
 - 200% if not corrected by deadline
- 10% tax on the manager(s) who “knowingly” approved the transaction, up to \$20,000 aggregate
- Bad publicity



Intermediate Sanctions

- Why “Intermediate”?
 - Gives IRS a remedy between doing nothing and revoking Exempt status
- Rule: *Cannot provide “Excess Benefit” to “Disqualified Person”*
- HR and Compensation professionals can assist the Board and senior management in complying

Intermediate Sanctions

- Special Rules for Smaller Organizations and Lower Paid Executives
 - Organizations with less than \$1 million annual gross receipts may use compensation data from just three comparable organizations in the same or similar communities for similar services.
 - Lower-paid executives are not “disqualified” if they receive economic benefits from the organization, directly or indirectly, of less than \$110,000. (Not available for CEO and other senior officials, or controlling parties.)

Rebuttable Presumption of Reasonableness (Safe Harbor)

Payments are considered reasonable IF

1. Advance approval by an authorized, disinterested group of the organization.
2. Appropriate comparability data is used.
3. The decision is documented by the later of 60 days or before the next meeting of the group.



Note – new Form 990 asks if this process is used

What's a Tally Sheet?

- A detailed list and values of all compensation provided by the organization and related organizations to disqualified executives
- Transparency and documentation
- Made available to key decision-makers
- Responds to historical cases where aspects of compensation were not fully disclosed to Trustees



Common Concerns Based on our Experience

- Are the executives who are publicly reported on Form 990 the same as the Intermediate Sanctions “disqualified” persons?
- Who is the “authorized body” and needs to approve compensation under the safe harbor? A compensation or executive committee? The full board?
- What process makes sense for our organization? Are the governing documents aligned?

Resources

Lawrence Associates has developed online resources to assure that executives and trustees have the most current information on important compensation topics.

These resources can be accessed directly from our [Website](http://www.lawrenceassociates.com) at www.lawrenceassociates.com or by bookmarking the links separately.

- ✓ [Lawrence Associates' upcoming webinars on executive compensation strategies and responses](#) February 24, 2010 under "Governance".
- ✓ Our continually updated [Blog](#) about executive compensation topics.
- ✓ Our executive compensation [NewsFeed](#) selecting articles directly from the news about executive compensation across industries and regions.
- ✓ Our regulatory update [Resources/News](#) page that includes articles, IRS pronouncements and regulatory activity and resource information.

Lawrence Associates

Compensation Consultants

Comprehensive compensation consulting solutions for trustees and directors, executives and managers of nonprofit organizations, spanning the continuum of healthcare, foundations, colleges and universities and other nonprofit sectors.

- Executive Compensation – competitive analysis; compensation strategy; incentive plan design; capital accumulation; perquisites; benefits, trustee education and response to media and public disclosure.
- IRS Intermediate Sanctions and Reasonable Compensation Review – analysis and certification under the IRS safe harbor rules.
- Wage and Salary Program Design and Incentive/Bonus Pay – variable pay/incentives, wage and salary program design; performance evaluation and other reward programs.
- Custom Competitive Analysis & Surveys – competitive analysis, custom-designed competitive market surveys and analyses of all sizes.

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Executive Compensation

Recruiting, retaining and motivating executives are essential to any successful enterprise. But that is just the beginning. Heading off litigation, delivering tax effective solutions, implementing succession planning, analyzing and preparing for the effects of business combinations and reorganizations are vital concerns as well. Our attorneys bring practical business sense to bear on the compensation issues that arise in today's highly regulated and competitive marketplace.

Studying each client's unique requirements, we employ an integrated, multidisciplinary approach, considering comparables, competitive market position, public disclosure issues, regulatory and compliance issues, tax concerns, corporate governance, as well as plain old business sense to resolve our client's needs.

Our attorneys assist with every aspect of executive compensation, including negotiating employment agreements, severance agreements, change-in-control agreements, indemnification arrangements, deferred compensation arrangements, long term incentive plans, and advising on retention issues arising out of mergers and acquisitions, and restructurings. Working with our Life Sciences, Corporate, Securities, Financial Institutions, Intellectual Property, Tax, Employee Benefits, Labor & Employment and Litigation practice groups, we tailor solutions that are specific to our client's needs.

Our clients include compensation committees and boards of directors of publicly traded corporations, hedge funds, private equity funds, senior executives, CEO's and leaders of major financial institutions, not for profits, real estate enterprises, family offices, news and entertainment companies.

From intellectual property protection to state of the art financings structures for Hospitals, Colleges and Universities, McCarter & English responds to the needs of a wide variety of non profit and institutional clients.

For more information, please visit us at www.mccarter.com

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Wrap-up

- We are happy to answer submitted questions for the final minutes of this presentation.
- Please join us for Part II on February 24, when we discuss case studies and examples.
- Please be sure to visit the links on our site for the upcoming Wednesday Webinars.
- This presentation will be available for download from www.lawrenceassociates.com