

The Association of the Bar of the City of New York

**THE IRS' NEW "TAX EXEMPT COMPENSATION
ENFORCEMENT PROJECT":
WHAT NON-PROFITS NEED TO KNOW**

**COMPENSATION SURVEYS
FOR NON-PROFIT EXECUTIVES**

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Introductions

- Paul R. Dorf, Ph.D., APD
Compensation Resources, Inc.
- James E. Rocco, CCP
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General thoughts on compensation

- Largest annual operating expense of most organizations
- Basis for determining other programs (benefits)
- “Black Box” – misunderstood and underappreciated
- Requirement for good governance on pay decisions
- Increased visibility by public and media
- Increasing scrutiny by regulators
 - Sarbanes-Oxley Act
 - Intermediate Sanctions (IRC §4958)
 - Job Creation Act (IRC §409A)
 - Offices of Attorneys General

Why do a compensation audit?

- Determine competitive compensation levels for similar jobs in comparable entities
- Evaluate placement of job within competitive market
- Determine need for corrective action (over- or under-compensation)
- Provide a rationale and justification for compensation decisions
- Provide Board of Directors with safe harbor by establishing a rebuttable presumption (IRC §4958)

Conflicting objectives

Be competitive and pay-for-performance

vs.

Compliance with applicable regulations

vs.

Conservation of funds

Methodology overview

- Establish compensation strategy
 - Clarify Board's philosophy on compensation
 - Understand organization's scope and complexity
 - Consider organization's financial resources
- Understand job duties and responsibilities
 - Background and experience of incumbent
 - Quantifiable aspects of the job
 - Position scope and responsibilities
 - Special knowledge and skills that make position unique

Methodology overview

- Identify similar non-profit peers (matched to organization type, operating budget, revenue, assets, geographic location)
- Identify similar for-profit companies
- Collect compensation data
 - Salary, incentives/bonuses, deferred compensation, benefits, supplemental benefits, perquisites, and employment agreement)
- Determine total compensation package (per IRC §4958)
- Identify any anomalies

Defining the labor market

- Type of non-profit
 - NTEE match (National Taxonomy of Exempt Entities)
- Scope and complexity of organization/program
- Quantitative measures
 - Budget, assets, staff size, clients served
- Geographic scope
 - National, regional, state, metro, local; urban, suburban, rural
- Special characteristics

Job analysis

- Prepare position description for each disqualified person (one who exercises substantial influence over the organization)
 - Define position scope, accountability and requirements, plus special skills and abilities
 - Interview management and Board to obtain additional job details and to validate written information

Disqualified persons

- Defined in Section 4958 (f) (1) as:
 - “Any person who was, at any time during the five-year period ending on the date of such transaction, in a position to exercise substantial influence over the affairs of the organizations...”
- Persons considered “disqualified persons” and subject to penalties:
 - Person who receives the “excess benefit”
 - Any member of his/her family who might be appointed recipient
 - Any officer, director, trustee who approved the excess benefit

Sources for data collection

- Non-profit data
 - Published surveys
 - Form 990s of comparable peers
- For-profit data
 - Published surveys
 - Proxy statements of comparable publicly-traded peers
- Consultant's database
- Custom survey of select peer organizations
- Employment/search firms

Tabulating and reporting results

- Evaluate credibility of sources
- Weight data to emphasize non-profit data
- Calculate “market consensus” based on various measures of central tendency (Appendix 1)
- Calculate competitive market range based on desired market target
 - $\pm 10\%$ of market median for salary; $\pm 20\%$ for total compensation
- Conduct comparative analysis of each executive with actual total compensation package

Reporting and safe harbors

- Prepare detailed report of methodology, findings, and recommendations with exhibits
- Request Opinion Letter from legal counsel
- Present to Board of Directors/Compensation Committee
- Obtain approval for recommendations and any steps for corrective action

Web resources

- www.irs.gov (Internal Revenue Service)
- www.guidestar.com (NFP research site)
- www.sec.gov (Securities & Exchange Commission)
- www.sarbanes-oxley.com (Disclosure information)
- www.oag.state.ny.us (NYS Attorney General)
- www.worldatwork.org (WorldatWork - association for compensation professionals; resource for annual compensation increase trend data)

For further information

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Appendix 1

Adjustment Factor Calculation

Survey indicates average salary of \$120,000, effective 01/01/05; data to be indexed to 11/01/05 and an annual adjustment factor of 4.0%.

Determine the # months between the survey's effective date and the adjustment date.

Survey effective date:	01/01/05
Adjustment date:	11/01/05
Difference:	10 months

Adjust survey data to account for the time difference.

4.0% divided by 12 months = 0.33% per month

0.33% multiplied by 10 months = 3.3% total adjustment

Survey data aged by 3.3% to determine the salary for the specified date.

\$120,000 increased by 3.3% = \$124,000 (rounded)