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Non-Profit Financial Managers

Do's and Don'ts of Executive Compensation

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Agenda

- Managing Risk of Intermediate Sanctions
 - Rebuttable Presumption of Reasonableness
 - Camp Proposal
- Reasonable Compensation
- Measuring Total Compensation
- Governance - 990
- Massachusetts Attorney General's Oversight Project
- Similarities to Dodd Frank Wall Street Reform and Consumer Protection Act

Managing Risk of Intermediate Sanctions

Rebuttable Presumption of Reasonableness

1. Independent Board approves the compensation before it is paid
2. The Board relies on external, third-party comparable market data
3. The basis of the Board's decision is contemporaneously documented in the Board Minutes

Managing Risk of Intermediate Sanctions

Rebuttable Presumption of Reasonableness

1. Independent Board approves the compensation before it is paid

- Must not pay before approved
- Approved by an authorized body of your organization
 - Permitted under state law to act
- Body composed entirely of individuals who do not have a conflict of interest

Managing Risk of Intermediate Sanctions

Rebuttable Presumption of Reasonableness

2. The Board relies on external, third-party comparable market data

- Compensation paid by similarly situated organizations
- Availability of similar services in the geographic area
- Current data compiled by independent firms
- Actual written offers from similar organizations competing for the services of the individual

Managing Risk of Intermediate Sanctions

Rebuttable Presumption of Reasonableness

3. The basis of the Board's decision is contemporaneously documented in the minutes

- Later of next meeting or 60 days
- Records are reasonable, accurate and complete
- Terms and dates of the transaction
- Members of the authorized body who were present
- Comparability data obtained
- The basis for any determination that is higher or lower than the range
- Any conflicts noted

Managing Risk of Intermediate Sanctions

Intermediate sanctions – Camp Proposal

Intermediate Sanctions

- Institute an organizational level tax equal to 10% of any transaction found to be an excess benefit
 - *IMPACT* – adds a monetary penalty to the organization for an infraction in addition to the reputational risk that already exists
- Eliminate the “rebuttable presumption of reasonableness.” Procedures that presently provide that presumption of reasonableness will be the minimum due diligence standards and create no presumption.
 - *IMPACT* – essentially shifts the burden of proof to the organization (even when the required steps of reviewing comparable information, having an independent committee and having contemporaneous documentation have been taken). In effect this enhances the need for organizations to tighten procedures in this regard and be prepared to defend decisions.

Managing Risk of Intermediate Sanctions

Intermediate sanctions – Camp Proposal

- Treat investment advisors (person/organization primarily responsible for investments) and athletic coaches as “disqualified persons”
 - *IMPACT – takes direct aim at institutions with large endowments that reward high performing advisors and influential coaches – both of whom are influential but may fall outside the current definition of disqualified person*
- Subject organizations exempt from income tax under sections 501(c)(5) and 501(c)(6) to the Intermediate Sanctions rules
 - *IMPACT – though reasonable compensation rules are already in play in order to avoid excess private benefit, this would subject labor organizations and trade associations to formalized rules on compensation*

Reasonable Compensation

Data points to use in determining whether compensation is reasonable

- Prevailing rates at comparable positions
- Job description and scope of work
- Compensation policy for all employees
- Resume
- Prior years compensation history
- General economic conditions
- Employer's financial position
- Arm's-length agreement and negotiation

Measuring Total Compensation

- Employment contract
- Deferred compensation agreements
- Severance provisions
- Bonus/tuition
- Year-end W-2 adjustments
 - Personal use of housing, maid, driver, etc.
 - Personal use of vehicle
 - Personal legal fees paid
 - Life Insurance, senior care, health benefits

Measuring Total Compensation

- Senior manager expense review
- Accounts payable or disbursements
- Credit cards/P-cards
- Administrative assistant
- Human resources and legal
- Travel agency
- Spouse
- Personal assistant
- Departmental ID

Governance - 990

- Part IV, checklist asks if the organization engaged in an excess benefit transaction
- Part VI, Governance asks the organization if it established a rebuttable presumption
- Schedule J, Detailed Compensation
 - Business expenses
 - Criteria used to establish compensation
 - Severance
 - Deferred compensation
 - Bonuses

Massachusetts Attorney General's Office Oversight Project

- AGO intends to make revisions to its annual financial report form – Form PC
- To solicit more, and more timely information about executive compensation at public charities in the Commonwealth
- AGO believes changes will lead to increased transparency as well as greater public understanding of the elements of executive compensation and the process used to set compensation levels
- AGO will first conduct a focused review at a number of the largest public charities in MA

"Your Organization has been included in the group of twenty-five such public charities on the basis of either: (i) overall gross support and revenue; (ii) the value of your chief executive officer's calendar year 2009 reported compensation package; or both."

- Pursuant to its authority under G.L. c. 12, Section 8

Massachusetts Attorney General's Office Oversight Project

- Secondary goal is to produce a report that will allow the AGO to present a comparative analysis of not just the compensation, but of the processes that were used to determine that compensation
- Request to complete prototype Schedule EC and EC-1 and make available to the AGO written responses to requests and copies of records set forth and described in the Information Requests
- Request was made December 17, 2012 and response due by January 31, 2013
- Prototype Schedule EC requests information for three calendar years and only with regard to organizations CEO
- Because part of MA Form PC open to public inspection
- Signed by Chief, Non-Profit Organizations/Public Charities Division

Massachusetts Attorney General's Office Oversight Project

Form PC, Schedule EC-1										
Please provide the following information with regard to your chief executive officer's compensation; there are three pages, one for each of calendar years 2009, 2010, and 2011.										
		Name of Organization			CEO Name					
		XYZ Not-for-Profit			Robert Butler					
Calendar Year 2009	Component A	Component B	Component C	Component D	Component E	Component F	Component G	Component H	Total, All Components	
I. Base Compensation	i.	750,000	-	-	-	-	-	-	750,000	
	ii.	-	-	-	-	-	-	-	-	
II. Bonus and Incentive Compensation	i.	-	-	-	-	-	-	-	-	
	ii.	-	-	-	-	-	-	-	-	
III. Other Reportable Compensation	i.	12,000	10,000	4,000	10,000	1,000	1,000	35,000	21,000	94,000
	ii.	-	-	-	-	-	-	-	-	-
IV. Retirement and Other Reportable Compensation	i.	24,500	250,000	-	-	-	-	-	-	274,500
	ii.	-	-	-	-	-	-	-	-	-
V. Nontaxable Benefits	i.	8,000	625	1,300	250	25,000	50,000	12,000	-	97,175
	ii.	-	-	-	-	-	-	-	-	-
Total		-	-	-	-	-	-	-	-	1,215,675

Instructions: The categories of compensation in rows I. through V. above correspond to columns (B)(i) through (D) on Form 990, Schedule J, Part II. To the extent that any of the figures in those columns on Schedule J, Part II are comprised of component parts, please provide the amounts for each of the component parts. This Schedule EC-1 shows columns for five components, though you may have more or fewer components. If you have more than five components, please provide a spreadsheet using the same format as this Schedule EC-1. As with Form 990 Schedule J, Part II, subrow (i) is for reporting compensation from your organization and subrow (ii) is for reporting compensation from related organizations (as that term is used in the Form 990).

Massachusetts Attorney General's Office Oversight Project

- Information Requests – Describe and detail
 - Components of compensation paid or vested and a description of any vesting triggers
 - Contingent compensation, severance or change of control
 - Deferred compensation
 - Metrics or criteria used to determine
 - How were metrics selected
 - By whom?
 - Who applies the metrics?
 - When are determinations made?
 - How are records kept?
 - List other compensation received from corporate entities that are not related or from service on corporate boards that are not related
 - If you do not collect this information, explain why

Massachusetts Attorney General's Office Oversight Project

- Information Requests – Describe and detail
 - Conflict-of-interest review policy
 - Written policies regarding payment or reimbursement of expenses
 - Any other perquisites?
 - Compensation Committee
 - List of members, copies of minutes, written reports, contract
 - Who participated in negotiations? Dates of negotiations?
 - Independent Compensation Consultant
 - Same types of questions as above
 - Reports and peer group interest
 - Approval by board or compensation committee
 - Minutes
 - Compensation philosophy
 - Target

Massachusetts Attorney General's Office Oversight Project

- December 2013 AGO Report conclusions
 - CEO compensation is complex, often including special retirement
 - CEO compensation is generally high, range of examined amounts, \$487,397 to \$8,827,494
 - Isolated payments and vesting events involving retirement can make year-to-year comparisons challenging
 - 19 of the 25 organizations reported some form of supplemental executive retirement program or "SERP"
 - Organizations approached setting compensation with care and attention to the IRS presumption or reasonableness standards
 - 23 of the 25 organizations used outside consultants to help

Despite the care, little evidence was found that the process restrained CEO compensation or its growth

Massachusetts Attorney General's Office Oversight Project

- AGO believes adding additional data points and aspects of analysis to the process of setting CEO compensation may lead to more moderate rates of increase, allowing more charitable resources to be devoted to the organizations charitable mission
- Examples of additional data points
 - Charge the compensation committee with evaluating the reasonableness of compensation for other segments of the charity's workforce as well as executives
 - Include analysis of the relative magnitude of the CEO's total compensation package in relation to that of the non-executive workforce
 - Consider the level of public support the charity enjoys in the form of exemption from property tax and other forms of taxation
- The AGO's new Schedule EC is intended to increase transparency by explaining the types of compensation, providing additional detail and by disclosing the compensation on a more current basis

Similarities to Dodd-Frank

- Similarities to Dodd-Frank?
- Pay Ratio Disclosure Rules
 - Proposed 9/18/13
 - If finalized, in 2014
 - Take effect in 2015
 - Reporting in 2016 proxy statements
- Section 953(b) of the Dodd-Frank Act requires
 - Disclose median annual total compensation of all employees except for the CEO
 - Disclose annual total compensation of the CEO
 - Disclose Ratio

Comments?



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