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NONPROFIT INSIGHTS

NONPROFIT COMPENSATION

Steps for Incentivizing Performance

Incentivizing performance can be a powerful tool for attracting and retaining top talent. In fact, more than 80 percent of top executives in the private sector participate in incentive plans.

Like their counterparts in corporate America, nonprofits are realizing that incentivizing staff is just good business. Recent studies have found that nearly a quarter of nonprofit organizations are now tying pay to performance.

Yet, there's no magic formula for creating an effective incentive plan. And laws regarding nonprofit compensation include severe penalties for non-compliance.

Start with a Competitive Salary

Of course, attracting and retaining top talent starts with offering a competitive salary. Compensation experts recommend comparing your organization's pay structure with at least 15 other organizations to determine competitiveness. Good sources of salary data include:

- Compensation surveys published in *Chronicle of Philanthropy* and *Non-Profit World*.
- Model board governance policies regarding compensation from The National Charities Information Bureau.
- The annual *Survey of Association Executives' Compensation* from the American Society of Association Executives.
- *Management Compensation Report for Not-for-Profit Organizations*, published by Towers, Perrin, Foster & Crosby, Inc.
- IRS Publication 1053, *Corporation Source Book of Statistics of Income*.
- *Executive Compensation Reports*, published annually by the Research Institute of America.
- Surveys of executive compensation published annually in *Business Week* and *Forbes*.
- Charity Navigator's *CEO Compensation Study*.

Consider the 3 Cs

Ultimately, an effective incentive plan must be **Carefully** designed, **Conscientiously** administered, and it must **Conform** to the culture of the organization. Consider these key steps in formulating a plan that incentivizes top performance:

Limit the plan. Start out by including only senior positions (CEO, senior vice president, vice president) in the plan. It is easier to add positions (like middle management groups) to the plan later than to withdraw them. Have your CEO and/or compensation committee select incentive-eligible positions based upon a detailed review and analysis of the organization's objectives and other relevant criteria.

Clarify award levels. State the minimum award, target award and maximum award levels, expressed as a percentage of base salary. For example, your executive director might be eligible for a target award of 15 percent of base salary and maximum award of 30 percent, while senior executives would be eligible for a target award of 10 percent and maximum award level of 20 percent. The award for meeting the minimum standards of the incentive might be set at 10 percent.

Establish performance measures. To be effective, an incentive plan should focus on three to six performance measures. These measures should feature a mix of organizational and individual objectives. Organizational performance criteria might include:

Steps for Incentivizing Performance, cont'd.

- Income growth
- Increased funding
- Cost savings
- Publicity/public awareness campaigns
- Staff utilization
- Fundraising
- Program development

Individual performance criteria might include:

- Quality of work
- Client satisfaction
- Personal productivity
- Teamwork

Because executive-level positions typically have a more direct impact on an organization's performance, incentives for a CEO should be strictly based on achieving organizational objectives. Moving down the organizational ladder, greater emphasis should be placed on individual goals.

Develop true incentives. The incentive award must be seen as a true reward for outstanding performance — not a normal and expected payment. If performance criteria are not met, there should be no award. At the same time, make sure the incentive is not so large that participants are encouraged to set unrealistically low goals or even finagle the numbers to hit their targets.

Proceed with Caution

Incentivizing performance requires careful planning and implementation. A poorly conceived incentive plan can result in either excessive payouts by your organization or performance goals that are unattainable.

FUNDRAISING IN CYBERSPACE:
New Traps on the Digital Frontier

What's not to like about online fundraising? The costs are generally low and the response high. And savvy nonprofits have found no end to the options — from soliciting donations through their own websites to partnering with online e-commerce sites or joining a "commercial donation" site such as http://igive.com.

But online fundraisers are operating in what is still a relatively uncharted area. Unwary nonprofits can easily find themselves facing significant legal complexities on this digital frontier. Consider these emerging challenges.

The Registration Conundrum

Increasingly, state regulators are investigating nonprofits that request donations online. Their contention is that even if a nonprofit is not physically located in a particular state, it is considered to be soliciting donations in that state if residents can access the site.

According to The Center for Non-profits, the state of Florida has actually taken action against at least one charity that was enrolled in an online "commercial donation service" but was not registered with the state.

The Form 990 "Gotcha"

The IRS's revised Form 990 makes it impossible to ignore out-of-state fundraising registration, requiring nonprofits to provide information about their state registration. For example, Schedule G, Part I, Question 3 reads:

> *List all states in which the organization is registered or licensed to solicit funds or has been notified it is exempt from registration or licensing.*

The bottom line is that if you do not register properly, your organization risks penalties and even felony charges. In addition, your auditors and grantors will also require that your fundraising registrations are in order.

The Tax Trap

Nonprofits partnering with for-profit entities online can open themselves to some unexpected tax liability in the form of the Unrelated Business Income Tax (UBIT). Even though an organization is tax exempt, it still might be liable for tax on income from an activity that is not substantially related to its exempt purpose or function.

Two common activities that could trigger UBIT are:

Hyperlinks and banner exchanges – In some cases, the IRS has ruled that including Internet hyperlinks to other entities actually constitutes "advertising," which is subject to UBIT. For example, banners and hyperlinks to a corporate sponsor on your charity's website could be problematic if they contain language that endorses or induces site visitors to purchase the sponsor's products or services — which the IRS contends is essentially "advertising." In this case, any sponsorship payments the nonprofit receives could be subject to UBIT.

But if the exchange of links or banners is merely an attempt to refer visitors to additional information, it generally would not be subject to UBIT. For example, a nonprofit weight-loss support group might exchange links or banners with a for-profit company that sells retail weight-loss products. Here, providing a link might be considered to be acting to further the nonprofit's exempt purposes and activities.

Virtual storefronts – As with traditional brick-and-mortar storefronts (like museum gift shops), the IRS looks to the primary purpose of sales on a nonprofit's Internet storefront. UBIT would apply if the sale of merchandise merely generates revenue as opposed to furthering the organization's exempt purposes.

Privacy Issues

A key issue of online privacy involves the sorting and storing of donor information for marketing purposes (aka data mining). Given rising concern over what data is collected online and how it's collected, the Federal Trade Commission (FTC) recommends that nonprofits that gather donor information online develop and post policies that outline what information is being gathered, how it is used and with which third parties it will be shared.

The FTC also recommends policies that disclose how the information is safeguarded, as well as an option for the donor to choose that his or her information not be shared with third parties.

Turn to our professionals to keep abreast of emerging issues of UBIT, charitable contributions and fundraising registration.

Unwary nonprofits can easily find themselves facing significant legal complexities with online fundraising.

KEEP IT LEGAL:
Tips for Determining Executive Compensation

Charitable organizations are certainly permitted to pay “reasonable” salaries. Likewise, revenue sharing and performance-related bonuses are also allowed.

But excessive compensation to directors and key employees can be grounds for the IRS to revoke an organization’s tax-exempt status under the private inurement rule.

The challenge is that the IRS has never stated exactly what dollar amount makes compensation “excessive.” At the same time, though, the IRS has assessed millions of dollars in penalties for these types of violations — and has also indicated it will include an excess compensation analysis in every future financial audit it conducts.

Head for Safe Harbor

A nonprofit executive’s compensation is generally not considered to be excessive if it is consistent with the compensation paid to executives with comparable jobs in comparable organizations. In general, if an organization meets the following safe harbor requirements, the IRS presumes that the compensation paid to the executive is reasonable:

Disinterested person(s) made the compensation decision. The individuals who decide the executive’s compensation must not have a personal interest in the compensation arrangement. Here, appointing or authorizing a committee to evaluate compensation may be wise.

Appropriate data is used in making the compensation decision. Data for comparable positions in comparable organizations should be used to determine the compensation package for executives. Applicable data may include:

- Researching compensation paid by similar organizations.
- Using a current compensation survey compiled by an independent company.
- Collecting actual written offers from similar organizations.

Note that the 1999 amendments to the Taxpayer Bill of Rights allow salary comparisons between nonprofit and for-profit employees.

The compensation decision is documented. The decision-making body of a nonprofit charitable organization must document the pay decision and approve the documentation. The documentation must contain the compensation terms for the executive, the date of the approval, person(s) approving the compensation, the data relied upon for the decision, and any actions by an interested member of the decision-making body. Be sure to prepare minutes of the meeting at which the decision was made.

Our experienced professionals can provide guidance in the critical area of executive compensation. Call us if you’d like to discuss this in further detail.

Fraud Watch: How to Beat Billing Schemes

The Association of Certified Fraud Examiners has identified billing schemes as the leading cause of fraud in nonprofits. These schemes come in a variety of flavors, including:

Shell company schemes – An employee submits invoices from a fictitious company.

Pay-and-return schemes – An employee arranges for overpayment of a vendor invoice and pockets the excess when it is returned to the company.

Personal purchase schemes – An employee submits an invoice for personal purchases, or uses a company credit card to make personal purchases.

Fortunately, billing irregularities are usually not that difficult to detect if you know what to watch out for. The key is to implement some sound policies and internal controls:

Require detailed purchase orders. All purchase orders should have a specific description of items, quantity, price, terms, delivery requirements and dates. Even better are pre-numbered purchase orders, which provide a simple way to detect and investigate missing purchase orders.

Create a vendor list. An approved vendor list makes it easy to match purchase orders to vendors, as well as investigate purchases made from vendors that are not on the approved list. One red flag to look for would be an employee's home address that matches a vendor's address.

Establish purchase limits. Set maximum purchasing limits for each employee.

Examine receiving reports. Look carefully at shipment receiving reports for merchandise ordered and paid for but not delivered.

Segregate duties. Do not permit the same employee to originate and approve purchases. Likewise, separate the invoice approval function from the payment and receiving function.