NYS Commission on Quality of Care and Advocacy
for Persons with Disabilities

Best Practices: Board Governance & Executive Compensation in Non-Profit Mental Hygiene Agencies

April 2010

JANE G. LYNCH
CHIEF OPERATING OFFICER

401 STATE STREET
SCHENECTADY, NEW YORK 12305-2397
1-800-624-4143 (Voice/TTY/Spanish)
www.cqcapd.state.ny.us

BRUCE BLOWER
PATRICIA OKONIEWSKI
MEMBERS

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Executive compensation has been under increased scrutiny in recent times, particularly when public funds are used to pay executives. This report examines compensation practices in government funded not-for-profit mental hygiene agencies in New York State and is designed to assist boards of directors in fulfilling their duty to set reasonable compensation for their executives.

To prepare this report, the Commission conducted an industry-wide compensation survey, including analysis of 658 agencies with a total of $9 billion in revenues and $96 million in CEO compensation; conducted site visits to selected agencies; and examined the regulatory framework in which the agencies operate. All of these activities were undertaken for the purpose of identifying best practices which can be easily replicated across the State to strengthen governance by agency boards of directors.

The Commission initiated the study by mailing letters to more than 1,200 provider agencies under the jurisdiction of the Office of Mental Retardation and Developmental Disabilities and the Office of Mental Health, requesting a broad range of information relating to executive compensation for a three-year period. The survey, which was to be completed on-line, focused primarily on the CEO/executive director position, although a limited amount of information was collected for other executive level employees. In all, over 750 agencies completed the survey and 658 of those responses were included in the Commission's final analysis. Perhaps not unexpectedly, the Commission found two primary factors which influenced executive pay levels across the State – agency size (based on its annual revenue) and geographic location.

The Commission also conducted site visits at 31 of the responding agencies to perform a more in-depth review of the data submitted and the practices employed in the setting of executive pay. Agencies were selected based on size and geographic location in an effort to include a broad cross-section of providers. These visits revealed a wide range of practices relating to executive compensation. Some agencies had very informal systems with minimal documentation, while other agencies had much more formal systems with compensation committees, annual evaluations, employment contracts and extensive documentation of the steps taken in arriving at executive pay levels. Through these visits, as well as a review of the Internal Revenue Service Intermediate Sanctions Law and other research discussed in this report, the Commission was able to identify several best practices as summarized below.

SUMMARY OF BEST PRACTICES

- Identify all forms and sources of compensation.
- Use an employment contract to delineate compensation and duties/responsibilities.
- Compare to similar jobs, at agencies of similar purpose, revenue size and geographic area.
    - Avoid heavy reliance on any one similar agency.
        - Prefer a larger sample.
        - Prefer reliance on the median rather than average.
    - The IRS Form 990 is the most common public source of compensation data.
        - Understand how compensation is reported on the form.
        - Ensure compensation is disclosed clearly and completely on your own filing.
- Approve compensation in advance of payment.
- Bar those with a conflict of interest from participating.
    - Maintain a written conflict of interest policy requiring disclosure within the agency.
- Contemporaneously record all deliberations and decisions in the minutes, including:
    - Detailed records of the information relied upon and its source.
    - The date and terms of approved compensation arrangements.
    - The specific vote cast by each member.

Government at all levels, as well as the public at large, expect, and are increasingly demanding, oversight, accountability, and transparency from agencies receiving government funding. By outlining the statutory and regulatory requirements relating to executive compensation, highlighting best practices, and presenting comparability data compiled by the Commission for more than 650 providers throughout the State, the Commission hopes this report can serve as an important tool for boards of directors in carrying out their responsibilities for setting reasonable compensation for their executives.

INTRODUCTION

The environment in which not-for-profit corporations operate has changed dramatically in recent years. Corporate scandals and questionable executive compensation have led to a public outcry for greater scrutiny and regulation of not-for-profits. Given today's economic climate, transparency and accountability in the expenditure of public funds are vital.

Notwithstanding the dedication which most not-for-profit agencies have demonstrated to serving people with disabilities, over the past two decades the Commission has documented cases of financial fraud, waste and abuse in the mental hygiene field. In each case, common threads were found which contributed to the diversion of funds away from care for individuals with disabilities; boards of directors failed in their fiduciary responsibility to oversee the corporation and executive directors placed their self-interest above that of the corporation.

The Commission began this study after two recent investigations into licensed mental hygiene agencies[1] found issues with the compensation paid to executive staff and, more importantly, disclosed a lack of oversight by boards of directors in determining that compensation. Accordingly, this report provides guidance for agencies looking to improve corporate governance based on the best practices of other agencies; examples of potential pitfalls in determining compensation; and ways in which analyses of comprehensive statewide data could aid boards in setting reasonable executive compensation.

SCOPE OF STUDY

For this study, the Commission solicited responses from 1,206 providers that serve individuals with mental disabilities under the jurisdiction of New York State's Office of Mental Health (OMH) or Office of Mental Retardation and Developmental Disabilities (OMRDD). In total, 754 or 63 percent of the agencies provided the requested information. Of this total, 658 were eventually used for analysis purposes.[2] In addition, the Commission conducted 31 site visits to agencies throughout the State to perform a more in-depth review of the practices of boards in determining how executive compensation was established and to verify whether the data provided in the survey response was accurate. Agencies were selected to ensure that a broad range of providers were included in the study; i.e., large, medium and small agencies in both urban and rural settings.

[1] PSCH, Inc.: An Investigation into Financial Practices and Corporate Governance, November 2008; Lessons Learned – Changes Made, The Case of Evelyn Douglin Center for Serving People in Need, Inc., February 2008.

[2] For analysis purposes, the Commission wanted to compare like agencies. Therefore, certain agencies such as county-operated providers or hospitals were eliminated from the study. Also, because this study focused on 2006 compensation, a few agencies were excluded because they reported zero compensation and several were excluded because their executive director held the position for only part of 2006. Additionally, in a few cases, related party entities under common control were combined, such as those which set up separate corporations to hold real estate.

The Commission's survey asked providers for the following:

- Compensation data for the executive director for 2004, 2005 and 2006.[3]
- Compensation data for the next four highest paid executives and their respective titles for 2006.
- Total agency revenue from all public and private sources.
- Total number of employees.
- The number of years the executive director was in both her/his current position and the number of years experience in their respective field.
- The education level of the executive director.
- The average number of hours the executive director worked per week.
- Whether the agency had an employment contract with the executive director.
- Whether the board of directors appointed a compensation committee.
- Whether compensation was approved by the board and documented in minutes.
- Whether compensation was determined on the basis of comparable data.

For the most part, when data is cited in the report it is for calendar year 2006 or fiscal year 2005/2006.[4]

[3] This data included the years ending December for upstate providers and the years ending June for downstate providers coinciding with the differing fiscal years required by the New York State Consolidated Fiscal Reporting System.
[4] The data presented in the report is based on self-reporting by the 658 agencies.

REASONABLE COMPENSATION

One of the primary duties of a board of directors is to fix the "reasonable" compensation of officers, directors and employees. According to the New York State Not-for-Profit Corporation Law (§202(a)(12)), such compensation shall be commensurate with the services performed. However, the definition of *reasonable* has been a matter of debate. In order to address this issue and curb compensation abuse at not-for-profits, Congress passed the Intermediate Sanctions Law, which is codified in Section 4958 of the Internal Revenue Code (IRC).[5] The law was enacted to apply penalties to individuals who misused their position in a public charity for private gain. Prior to the enactment of the law, the only option for the IRS was to revoke a charity's tax exemption. The law and the final regulations (which were issued in January 2002) define key terms and provide extensive guidance for boards when determining reasonable compensation. At the heart of the law is the "excess benefit transaction."[6] When an excess benefit transaction has occurred, tax sanctions may be imposed on the person[7] who improperly benefitted from the transaction and possibly on organization managers who participated in the transaction if they knew that it was improper.

The Internal Revenue Service (IRS) regulations define reasonable compensation as "the amount that would ordinarily be paid for like services by like enterprises (whether taxable or tax-exempt) under like circumstances" (26 C.F.R. §53.4958-4). The regulations provide a rebuttable presumption that compensation will be presumed to be reasonable if the corporation follows certain prescribed procedures in approving the transaction. These procedures, in effect, represent "best practices" and provide the best evidence available that no excess benefit transaction has occurred.

In order for the presumption to apply, three requirements must be met:

- the compensation arrangement was approved in advance by members of an authorizing body of the organization, none of whom had a conflict of interest with respect to the transaction;
- the authorizing body obtained and relied upon appropriate data as to comparability prior to making its determination that the compensation arrangement in its entirety is reasonable; and

[5] Internal Revenue Code of 1986, as amended, section ("IRC §") 4958, enacted by §1311(a) of the Taxpayer Bill of Rights 2, P.L. 104-168, 104th Cong., 2d Sess. (1996), 110 Stat. 1452 ("Act").
[6] An excess benefit transaction is defined as "any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing the benefit" *Internal Revenue Code §4958(c)(1)(B).*
[7] Individuals who may be subject to sanctions are defined as a "disqualified person." This includes any person who was, at any time during the five-year period ending on the date of the transaction involved, in a position to exercise substantial influence over the affairs of the organization; a member of the family of an individual described in the preceding category; and, an entity in which individuals described in the preceding two categories own more than 35 percent of an interest. *IRC §4958(f)(1)(A), (B), & (C).*

- the authorizing body documented the basis for its determination concurrently with making its decision.

As noted above, the regulations and legislative history stress that "appropriate data as to comparability" are to be assessed. According to the regulations, such information can include, but is not limited to:

- compensation levels paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions;
- the availability of similar services in the geographic area of the applicable tax-exempt organization;
- current compensation surveys compiled by independent firms; and
- actual written offers from similar institutions competing for the services of the individual involved.

These criteria are not all-inclusive; many other factors can and should be used when determining a reasonable compensation. These include: the need of the organization for the services of a particular individual; the experience of the individual, both in the position to be filled or in the industry; the employee's role in the company, including hours worked, duties routinely performed, plus any special duties; the amount of time an individual devotes to the position (compensation may be considered reasonable for a full-time position, yet unreasonable if the same amount were paid to the individual working on a part-time basis); the character and condition of the organization; and the consistency of the compensation system throughout the ranks of the organization.

PART I

BEST PRACTICES

As part of this study, Commission staff visited 31 agencies across the State to look behind the data reported in the survey. The focus of these visits was to verify compensation amounts reported online, and to examine the various processes used by the selected agencies to arrive at the amounts being paid to top executives. This involved looking at items such as board minutes, employment contracts, employee benefit plans, and comparative salary data, if used. The results of these visits revealed a broad range of practices relating to executive compensation. Some agencies were found to have very informal systems with minimal documentation while other agencies had much more formal systems, with compensation committees, annual evaluations, employment contracts and extensive documentation of the steps taken in arriving at executive pay levels. Some of the best practices found were those that closely mirrored the requirements of the IRS reforms noted above.

While there are many different ways for boards of directors to fulfill their fiduciary duties and ensure compliance with applicable laws and regulations relating to executive compensation, the following is a list of steps and examples the Commission believes to represent best practices in setting reasonable executive compensation levels.

1. Forms and Sources of Compensation

The key to transparency and accountability in setting executive compensation is documentation. One of the most common problems found during this study was the failure of an agency to identify and include all forms of compensation in its analysis of executive pay. Approvals of executive compensation packages routinely focused on annual salary alone, often excluding other items such as bonuses, deferred compensation arrangements, pension and profit-sharing contributions, welfare benefit plans[8] and the value of employer provided automobiles. Because the level of benefits varies, all of these items, even if not includable as taxable income of the recipient, must be considered when assessing the reasonableness of an individual's compensation package. Furthermore, if the agency has a related party foundation, real estate holding company or other related party corporation which is also providing some compensation, the combined total compensation from all entities should be evaluated. While the above list is not by any means all-inclusive, it contains items commonly overlooked by boards and compensation committees.

Simply preparing a schedule listing the annual salary and all other forms of compensation, both cash and non-cash (*e.g.*, bonuses, deferred compensation, pension and profit sharing plan contributions, and welfare benefit costs), and including it in the agency's board minutes, is an excellent way to document that the board of directors is aware of and approving the executive's total compensation package. The Commission found two good examples of this practice during its site visits. Detailed schedules included in the board minutes listed not only annual salaries, but also bonuses, deferred compensation, pension and profit sharing plan contributions, and welfare benefit costs.

2. Employment Contract

> **Survey Results:** 38 percent of CEOs had a written employment contract.

Another method of documenting executive compensation is through the use of an employment contract. An employment contract serves two main purposes. First, it describes the employee's responsibilities in the agency, e.g., his or her duties, work hours and other terms of employment. Second, the contract details what the employer will do for the executive (e.g., setting compensation, including salary, benefits, vacation and sick leave and other items such as severance

[8] Welfare benefits include non-taxable benefits such as, health insurance, educational assistance, life insurance, medical reimbursement programs and disability benefits.

pay, if any). The board should also evaluate the degree to which performance incentives might prove to be an effective tool in promoting "excellence" among agency management.

Employment contracts should list, in detail, all forms of compensation to be provided and the terms of the contract should be strictly adhered to. The Commission found that in some instances, while an agency entered into a contract with its chief executive, the executive received additional compensation outside of the terms of the contract without explanation. In one instance, an executive director received two salary supplements, in addition to the base salary stated in his contract. In 2006, these payments totaled over $31,000 and represented an 11 percent increase over the individual's approved salary. Situations like this could potentially run afoul of the IRS Intermediate Sanctions rules, subjecting both the executive and the organization to substantial penalties.

3. Appropriate Comparability Data

> **Survey Results:** 70 percent of boards/committees used comparable data.

One of the best ways a board can ensure that executive pay is reasonable is to obtain appropriate data as to comparability. There are many sources for comparability data available to boards of directors today, some at little or no cost to the organization. Agency IRS filings (Form 990), which list executive compensation, are available at no cost through the New York State Attorney General's website *www.oag.state.ny.us* and at *www.guidestar.org*. GuideStar also publishes annual compensation surveys which are available at little cost. Not-for-profit trade associations also routinely offer data to member organizations. Many larger agencies engage the services of consulting firms which specialize in executive compensation. These services, however, can often involve significant cost to the agency. The Commission found the cost of outside compensation studies to range from a few thousand dollars to more than $20,000 for one study.

The most important factors in gathering comparability data are choosing appropriate organizations and documenting those selected. Agencies selected for comparison should be similar in size and type (annual budget, number of employees, types of services offered, etc.) and in geographic location (rural, small city, large city, etc.).[9] Documentation of selected agencies should, at a minimum, include the name, location, annual revenues of the organization and a list of position titles and the related compensation, with the source of such information identified.

It should be noted, however, that although reviewing comparability data is important, sources of compensation data, such as the Form 990, are prone to error. Generally, data collected may contain outliers or one-time spikes which can greatly widen the range and skew the average. Therefore, while comparability data is important, boards should avoid heavy reliance on any one

[9] The Commission performed a statistical evaluation of survey data and found that the two strongest factors influencing compensation were the amount of agency revenue and the geographic region. These two factors are consistent with the comparability standards for similarly situated organizations.

comparable, and use the *median* rather than the *average*. In the same vein, it is better to utilize data from a larger sample, rather than relying on a few data points in order to minimize improper bias from faulty data.

Once appropriate comparability data is gathered, board members must make an objective assessment of where their executives should fall in the range of data collected. Everyone would like to believe that their employees are top performers and this is often the case with those individuals who rise to leadership roles in any organization. However, by definition, not all executives can or should be placed in the top 25 percent of executive pay. Just as there are reasons to place an individual in the 75th percentile of executive pay, there are an equal number of reasons why other strong performing individuals may be placed at the 25th percentile. Years of service, education levels, credentialing and specialized skills are all factors which should be considered in determining compensation. If every board routinely chose the 75th percentile as the target for their executives, pay would continually rise with no relationship to performance, resulting in "compensation creep."[10]

The Commission found this area to be problematic at the agencies that it visited. While many of the agencies reported that they used comparability data when determining executive compensation, the comparability data used was often too generic to be useful or difficult to correlate to the agency. For instance, one downstate agency simply provided, as its comparability data, a list of the names of other agencies located in the geographic area without any further information such as the revenue of the agencies or the compensation paid to the agencies' executive director. At a rural upstate provider, the Commission found that the provider was using information from organizations which were much larger in size and almost exclusively from the New York City and Long Island areas.

4. Board Approval

Survey Results

- 95% of boards approved the CEO's compensation
- 79% documented approval in the board minutes
- 58% of the boards had a compensation committee

In addition to documenting the entire compensation package and comparability data, boards of directors should carefully document the approval process in advance of the compensation actually being paid. This documentation should include a list of members in attendance at the board meeting when the compensation package was approved, along with a record of each vote on the compensation package. Any member of the board who is not a disinterested party should abstain from the entire process, from data collection to deliberation and voting. Disinterested members are those who are not related to or subject to the control of the individual whose compensation is being discussed. As a best practice regarding

[10] The Commission's site visits found that many agencies pegged their executive's compensation at the 75th percentile when using comparable data. However, in a May 2006 IRS conference regarding executive compensation, IRS representatives stated that "The higher you go above the 50th percentile, the better evidence you need to present to be able to show that the compensation is reasonable."

conflicts of interest, the Commission recommends that agencies have in place a written policy requiring disclosure of interests that could give rise to conflicts.[11] In no instance should the individual whose pay is being discussed be present during the board's deliberations or vote. Additionally, in cases where a compensation committee has been authorized by the full board, as a best practice, the committee should make recommendations to the full board which would then vote to approve the compensation package.

5. Reporting – Full Disclosure

Again, keeping in mind the themes of transparency and accountability, organizations must ensure that executive compensation is disclosed clearly and completely on its public filings and government reports. The IRS Form 990 requires disclosure of compensation provided to officers, directors, key employees and the five highest paid employees and independent contractors. Failure to fully disclose compensation to the IRS without reasonable cause may lead to IRS sanctions or penalties.[12] Boards of directors should ensure that effective internal controls have been implemented to minimize reporting errors.

PART II

COMPARABILITY DATA FOR ESTABLISHING EXECUTIVE COMPENSATION

To help boards take advantage of the best practices related to the analysis of comparability data in establishing a reasonable compensation package for executive directors, the Commission has compiled and analyzed the compensation of the executive directors for 658 agencies which voluntarily reported data to the Commission. In an effort to show how comparability data can be useful, the Commission performed certain statistical analyses and utilized different charting methods.

1. Factors Impacting Pay

The Commission performed a series of regression analyses to find attributes having a statistically significant influence on compensation levels.[13] The attributes examined included:

1. the size of the agency (e.g., revenue, number of employees);
2. the geographic region of the agency; and
3. certain personal characteristics of the executive director (e.g., hours worked per week, education level, number of years in the field, and number of years in the position).

---

[11] A sample conflict of interest policy is provided by the IRS as an appendix to the instructions for Form 1023 (Application for Recognition of Exemption).

[12] IRC §6652(c), IRC §4958-4(c)(3)

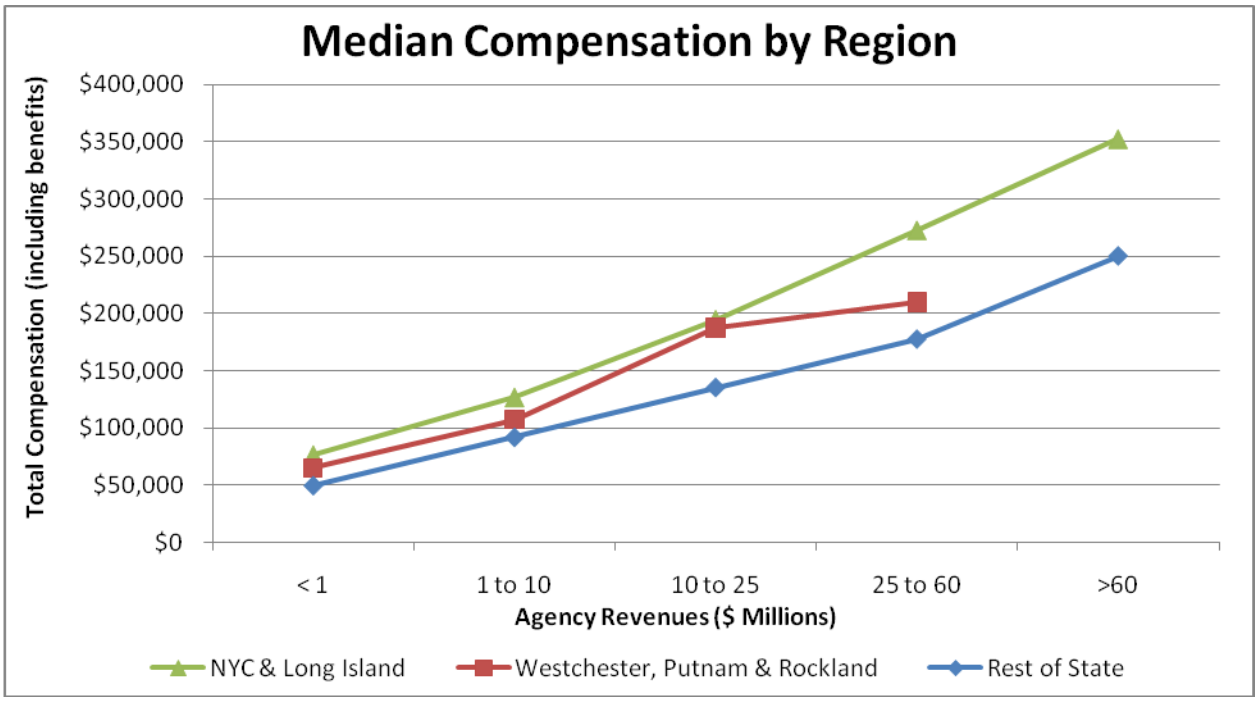
[13] Regression analysis is a statistical technique used to find relationships between variables. Results can be used for prediction, hypothesis testing, and modeling causal relationships.

Overall, the statistical analysis was able to show that two-thirds of the variations in executive director compensation can be explained by three factors: agency size, geographic region, and the number of years in the position.[14] Most of the charts in this report will focus on the predominate factors of agency size and region. Because the number of years an executive served had less of an impact, it will be discussed later in the report.

Agency size was by far the most significant factor for predicting executive compensation. The Commission found that about 60 percent of the variation in compensation levels was related solely to the size of the agency as measured by its annual revenue.

As one may expect, the next statistically significant factor impacting executive compensation was the region of the State in which the agency was located. The following three groupings best accounted for the regional differences in executive director compensation levels:

1. **New York City and Long Island** (Bronx, Brooklyn, Manhattan, Queens, Richmond, Nassau and Suffolk counties),
2. **Westchester, Putnam, and Rockland Counties,** and
3. **Rest of State** (all other counties). [15]

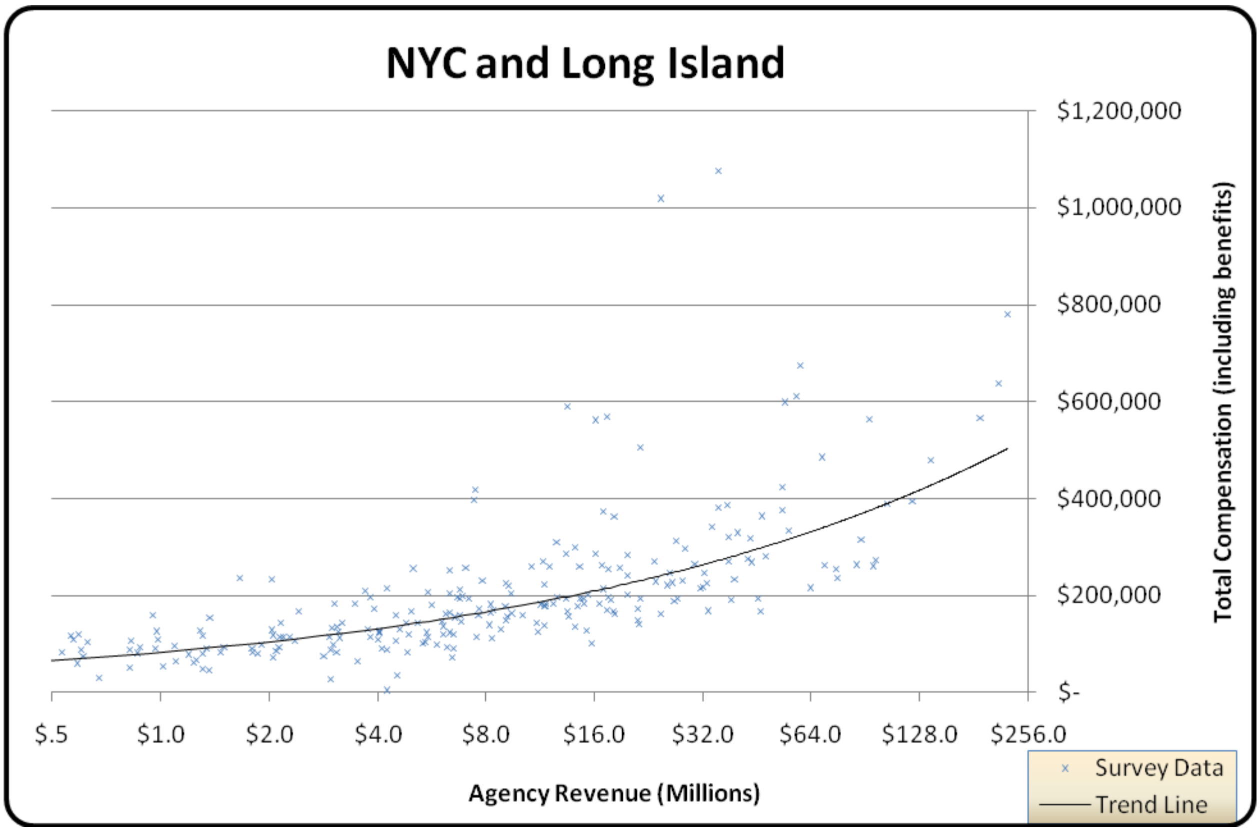


[14] Statistical prediction strengths (r-squared statistics) are 61 percent for agency size alone, 66 percent for agency size and region, and 67 percent for agency size, region, and the number of years in the position.

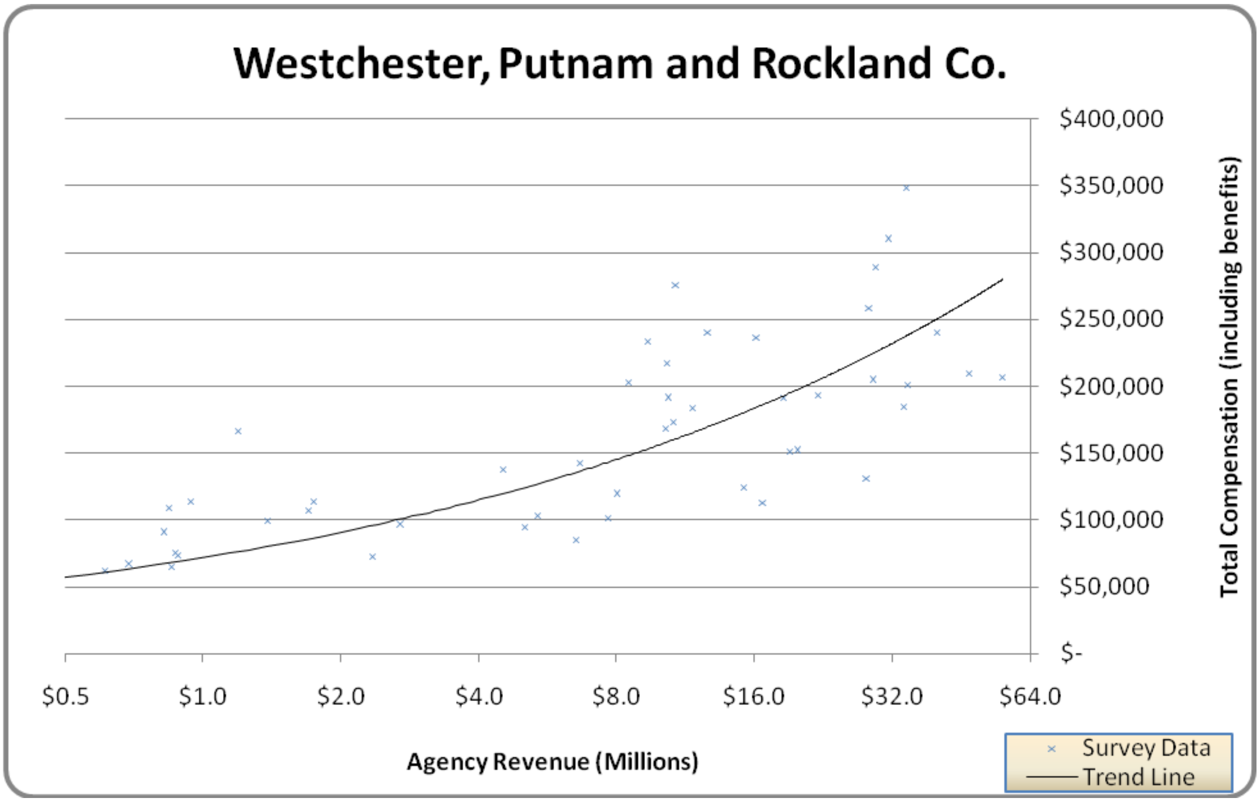
[15] The Commission performed a number of analyses examining the regional groupings commonly utilized by OMRDD and OMH for rate-setting purposes. Frequently, higher reimbursement rates are set for New York City, Long Island, and the metro-NY counties of Westchester, Putnam, and Rockland. For clinic rates, OMH further segregates the remaining State counties into two groups - - Hudson River Valley and Central/Western New York. Using these groupings, and combinations thereof, the Commission found that there were indeed some statistically significant regional variations.

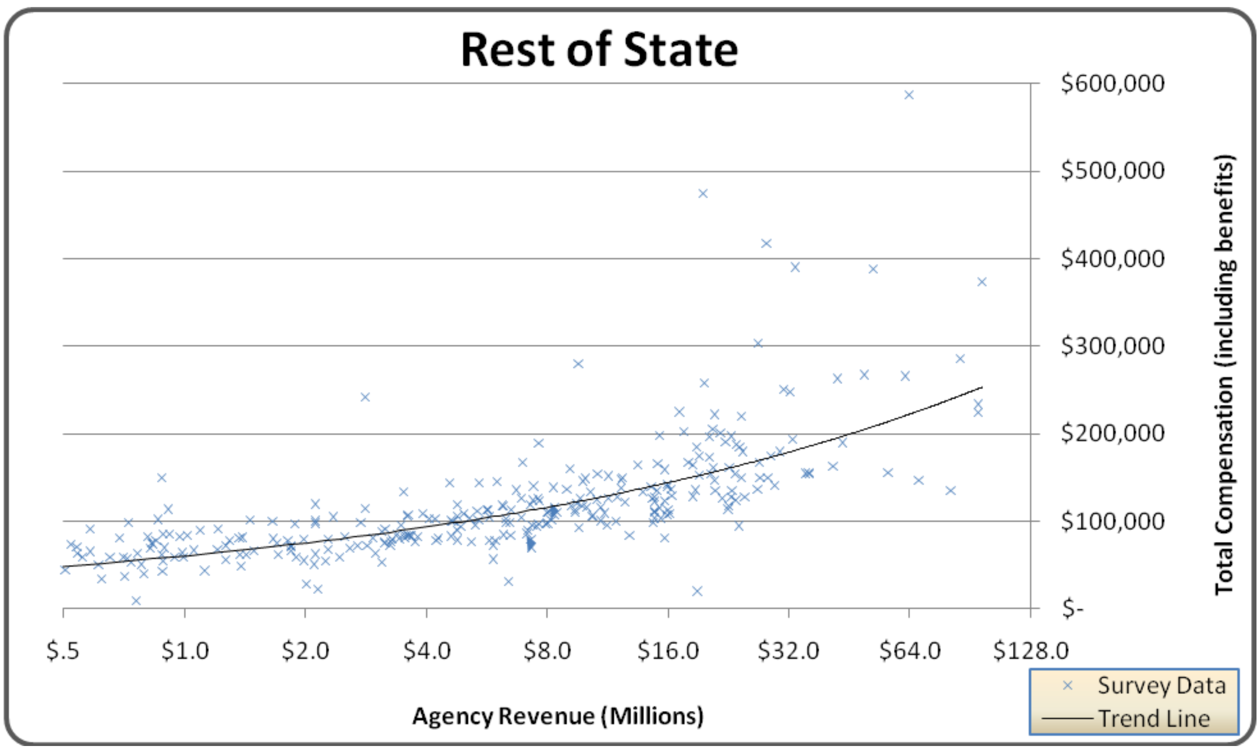
2. Scatter Charts

In order to make the data more meaningful, the survey information was segregated into the three geographic regions noted above. Although the following charts still show significant variability, the general trend of rising compensation in relation to agency revenue is more evident.[16] The impact of both agency size and its geographic location is logical given the increased complexity of running larger agencies and the higher cost of living in New York City and the surrounding areas. Because of this correlation, these factors should be carefully considered by any board of directors when setting executive compensation levels.



[16] In an effort to avoid the crowding of data points, data for the smallest agencies (those under $500,000 in revenue) were excluded and, logarithmic scaling was used on the horizontal axis to spread out the agency revenue. As a result, the individual data points become readily differentiated.


Westchester, Putnam and Rockland Co.
$400,000
$350,000
$300,000
$250,000
$200,000
$150,000
$100,000
$50,000
$-
Total Compensation (including benefits)
$0.5
$1.0
$2.0
$4.0
$8.0
$16.0
$32.0
$64.0
Agency Revenue (Millions)
Survey Data
Trend Line

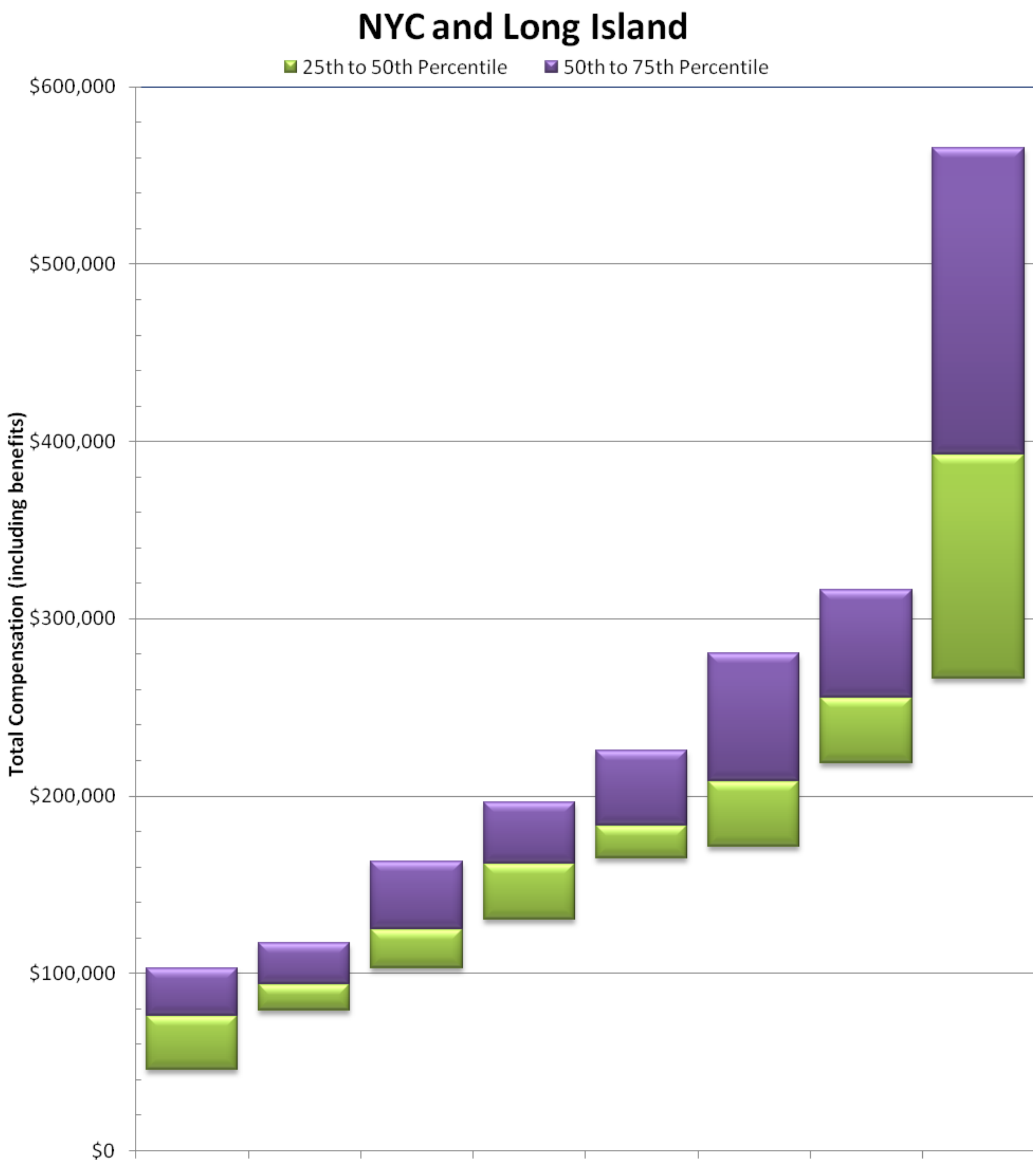

Rest of State
$600,000
$500,000
$400,000
$300,000
$200,000
$100,000
$-
Total Compensation (including benefits)
$.5
$1.0
$2.0
$4.0
$8.0
$16.0
$32.0
$64.0
$128.0
Agency Revenue (Millions)
Survey Data
Trend Line

3. Quartile Charts – Utilizing the Median and Quartiles

A common approach to summarizing compensation data is through the use of quartiles. This often concentrates on the two middle quartiles, from the 25th to the 50th percentile, and from the 50th to the 75th percentile, with the 50th percentile being the median or middle data point.

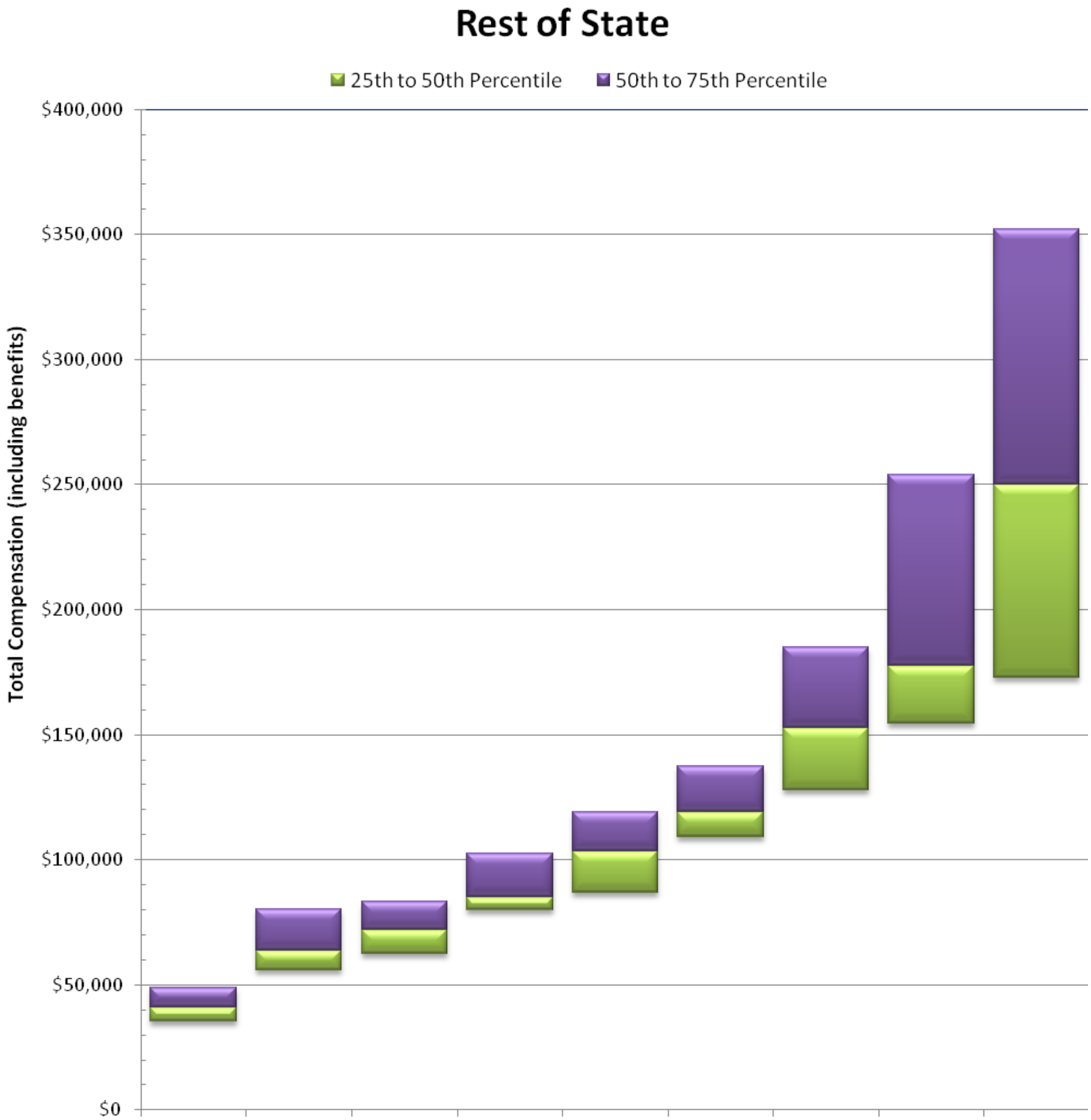
The next series of charts illustrates the use of quartiles by breaking out the data by region into groups based on agency revenue (i.e., grouping agencies with revenue from one to three million, three to six million, etc.). These groupings were developed independently in an effort to distribute the survey data evenly across the revenue ranges. Identifying the median compensation by agency size within a geographical region should provide board members with a reasonable starting point in setting a reasonable compensation for their executives.

Within each revenue grouping, the survey data is further broken down into four additional groupings or "quartiles." Each quartile contains 25 percent of the survey responses. For instance, if there were 100 responses in the survey, the data would be sorted from low to high and then broken out into four groups, 1 to 25, 25 to 50, 50 to 75 and 75 to 100. The use of quartiles is a common approach used to describe compensation data. The charts below display the middle two quartiles, one shaded bar for the 25th to 50th percentile, and a different shaded bar for 50th to 75th percentile. The meeting point of these two bars is the 50th percentile, which represents the median value, or middle data point. For example, for the New York City/Long Island region (see chart below), the median compensation (50th percentile) at an agency between \$6 to \$9 million dollars was \$161,600. In other words, in 2006, a board member at an agency within this range size and in this region, should have expected its executive director to be earning somewhere around the median compensation amount.



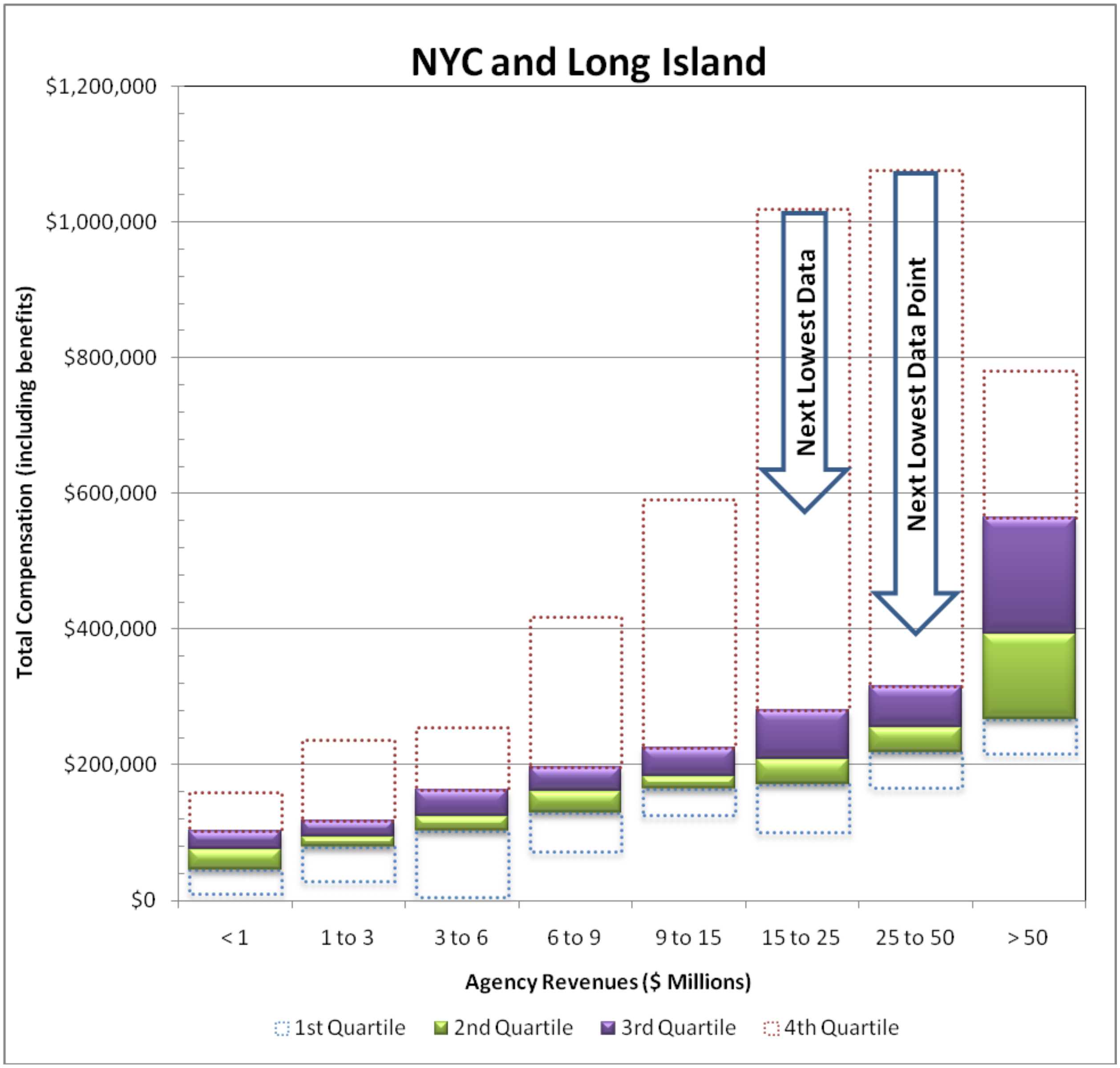
Total Reported Compensation	Agency Revenue in Millions							
	< $1	$1 to $3	$3 to $6	$6 to $9	$9 to $15	$15 to $25	$25 to $50	> $50
Highest	$ 158,800	$ 237,300	$ 255,900	$ 417,900	$ 590,700	$1,019,400	$1,076,400	$ 780,800
75th Percentile	$ 102,900	$ 117,300	$ 163,300	$ 196,700	$ 225,700	$ 280,400	$ 316,600	$ 565,300
50th Percentile	$ 76,200	$ 93,700	$ 124,600	$ 161,600	$ 183,300	$ 208,300	$ 255,700	$ 392,900
25th Percentile	$ 45,600	$ 79,100	$ 103,000	$ 130,000	$ 164,900	$ 171,600	$ 218,500	$ 266,500
Lowest	$ 9,600	$ 27,900	$ 5,200	$ 72,500	$ 126,300	$ 101,400	$ 166,800	$ 216,700
	n=34	n=37	n=39	n=33	n=34	n=30	n=30	n=22

Total Reported Compensation	Agency Revenue in Millions < $0.5	$0.5 to $2	$2 to $10	$10 to $20	> $20
Highest	$ 90,000	$ 166,400	$ 233,300	$ 275,800	$ 348,400
75th Percentile	$ 60,500	$ 110,000	$ 140,100	$ 217,000	$ 266,000
50th Percentile	$ 42,700	$ 95,100	$ 103,400	$ 184,000	$ 208,100
25th Percentile	$ 30,400	$ 71,700	$ 95,700	$ 152,500	$ 199,000
Lowest	$ 8,500	$ 61,900	$ 72,500	$ 112,900	$ 131,000
	n=11	n=12	n=11	n=13	n=12



Total Reported Compensation	< $0.5	$0.5 to $1	$1 to $3	$3 to $5	$5 to $8	$8 to $15	$15 to $25	$25 to $50	> $50
	Agency Revenue in Millions								
Highest	$ 78,400	$149,800	$242,200	$144,200	$189,300	$280,300	$475,000	$417,700	$587,800
75th Percentile	$ 48,500	$ 80,400	$ 83,500	$102,600	$119,100	$137,300	$185,100	$254,100	$351,900
50th Percentile	$ 40,800	$ 63,800	$ 72,100	$ 85,000	$103,300	$118,900	$152,800	$177,400	$249,900
25th Percentile	$ 35,300	$ 55,700	$ 62,300	$ 80,000	$ 86,900	$109,100	$127,800	$154,600	$172,700
Lowest	$ 3,600	$ 9,300	$ 22,300	$ 52,600	$ 31,400	$ 83,800	$ 20,200	$136,200	$135,300
	n=44	n=38	n=49	n=36	n=42	n=48	n=53	n=20	n=10

While the quartile charts presented above display only the middle two quartiles, the numbers shown in tables below those charts include the highest and lowest reported data point which would be used to set the boundaries for the first and fourth quartiles. The follow chart depicts the first and fourth quartiles, using dotted bars. The effect of outlying data points can be readily seen. In general, the bars for the fourth quartiles cover a much wider range than the lower quartiles. In this case, it is particularly evident in the $15 million to $25 million and the $25 million to $50 million ranges where the top compensation is over a million dollars. As the arrows indicate, each of these two quartiles is stretched much higher due to one outlying data point. Because one extraneous data point can cause the extremity to be misleading, the first and fourth quartiles are often not graphed as part of compensation surveys.

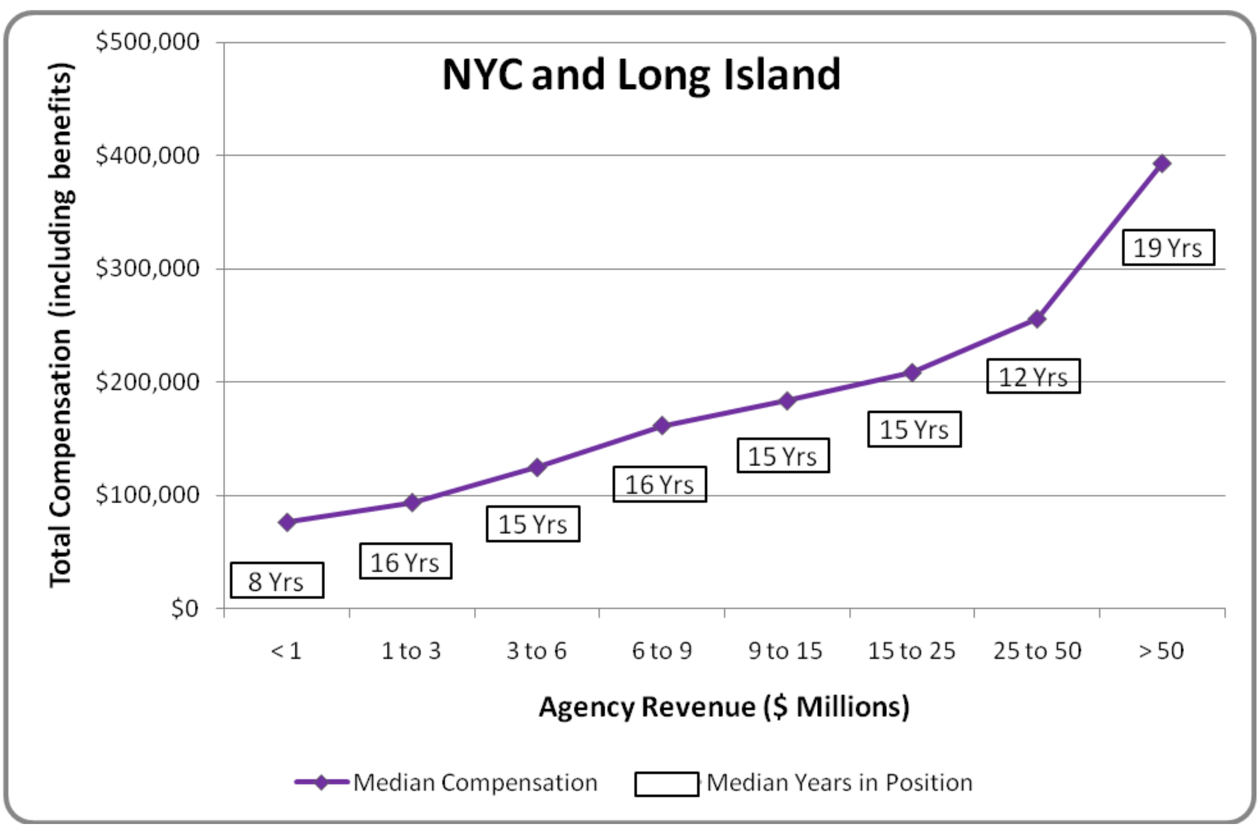


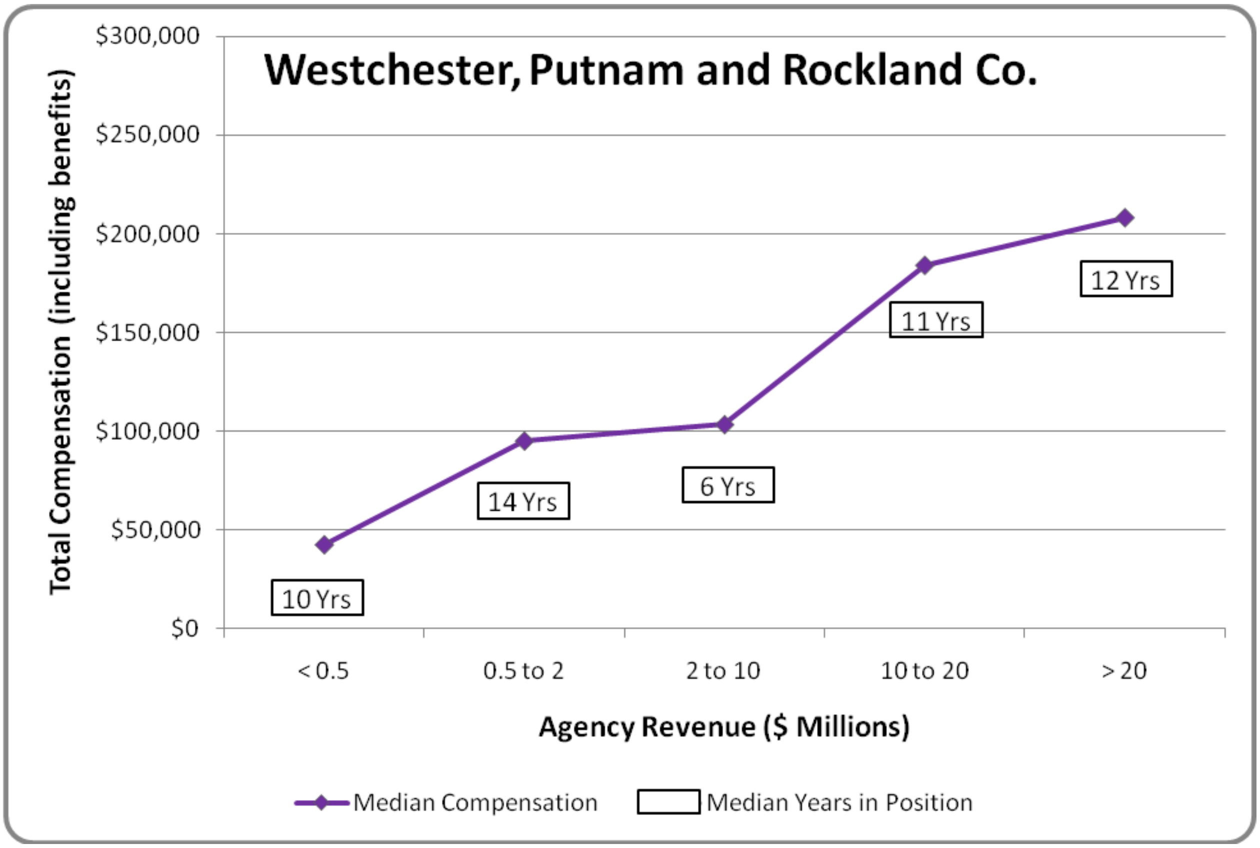
Not only can outliers greatly widen the range of data, they may also inappropriately skew the average. Because of numerical tendencies, the Commission recommends using medians, rather than averages, when relying on comparative data. This recommendation considers that averages tend to be higher than the medians because the upper quartile is open-ended while the lower quartile can go no lower than zero; when an outlier is present, the average can be skewed much higher. In the cases above, the two outliers were the result of an IRS reporting requirement which occasionally leads to the double counting of certain deferred benefits (see discussion on p.23); the double counting caused the averages to be higher, but had no effect on the medians, thus illustrating the reason for reliance on medians instead of averages.

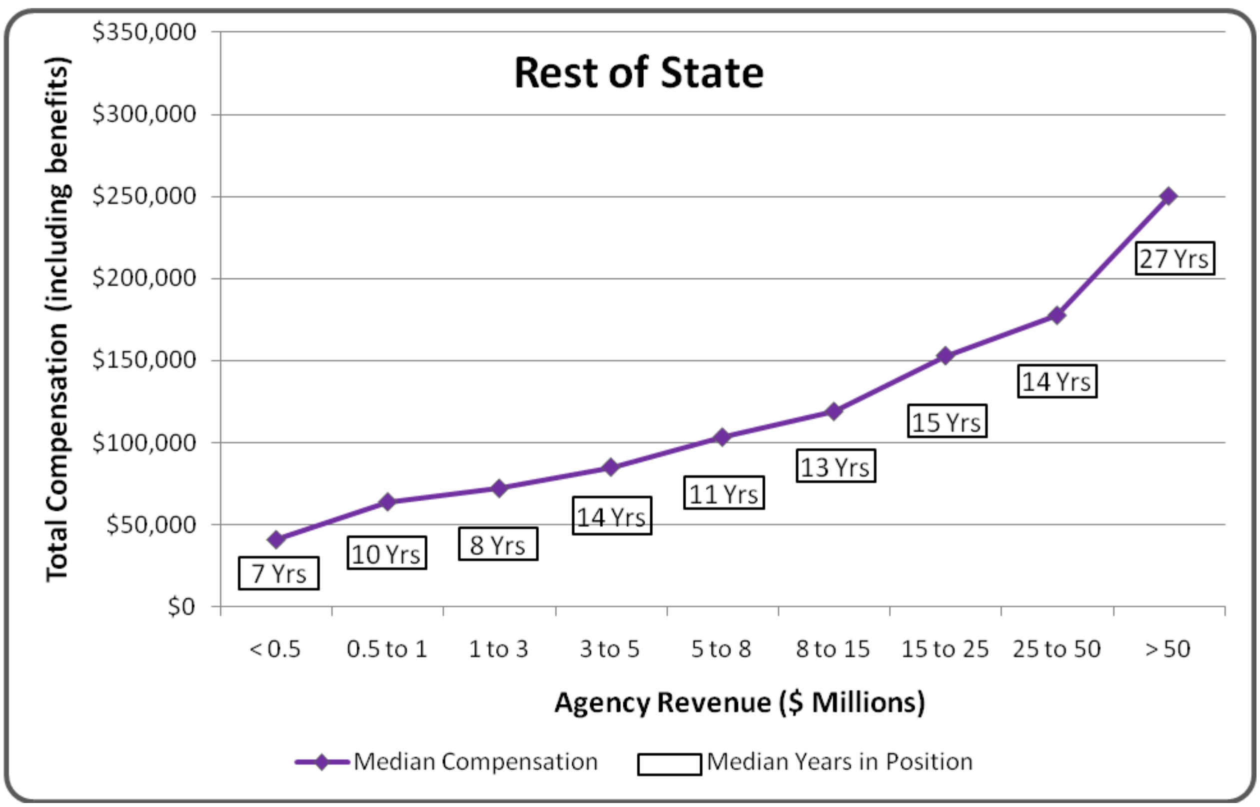
4. Tenure

The length of time the executive director has been in the position, also referred to as tenure, was found to slightly improve the statistical predictability of the compensation level; i.e., the greater the length of service, the higher the pay level.

The following charts reflect the median tenure of executive directors, again broken out by region and agency size. In some cases, it appears evident that the tenure is linked to a dip or spike in compensation. For example, in the Westchester, Putnam and Rockland region, the lowest median tenure of six years coincides with a dip in compensation. Conversely, on the other two charts (NYC/LI and Rest of State) the longest tenures of 19 and 27 years respectively, appear to correspond with a greater rise in compensation.




Westchester, Putnam and Rockland Co.
Total Compensation (including benefits)
$300,000
$250,000
$200,000
$150,000
$100,000
$50,000
$0
10 Yrs
14 Yrs
6 Yrs
11 Yrs
12 Yrs
< 0.5
0.5 to 2
2 to 10
10 to 20
> 20
Agency Revenue ($ Millions)
Median Compensation
Median Years in Position


Rest of State
Total Compensation (including benefits)
$350,000
$300,000
$250,000
$200,000
$150,000
$100,000
$50,000
$0
7 Yrs
10 Yrs
8 Yrs
14 Yrs
11 Yrs
13 Yrs
15 Yrs
14 Yrs
27 Yrs
< 0.5
0.5 to 1
1 to 3
3 to 5
5 to 8
8 to 15
15 to 25
25 to 50
> 50
Agency Revenue ($ Millions)
Median Compensation
Median Years in Position

Although tenure emerged as a subtle commonality in the statistical models, and paying a longtime executive more than someone new makes sense, this should not exclude boards from considering other personal characteristics when setting compensation (e.g., education level, other experience, part-time vs. full time, etc.).

UTILIZING DATA - A CASE EXAMPLE

The Commission has developed the following example to illustrate how the board of a not-for-profit agency might use data to help set the compensation for its executive director. Note that while the data presented in this report and applied in this case example pertains to the year 2006, the data can be adjusted to reflect current economic conditions.

For this example, we will use a fictitious not-for-profit mental hygiene provider located in the New York City area with annual revenues totaling just over $17 million. The compensation committee of the board of directors has been asked to evaluate and make recommendations to the full board regarding the compensation package of the executive director. The executive director is a highly qualified individual with a master's degree and more than 20 years experience in the field. This individual has been with the agency for eight years and in the position of executive director for the last three years. This individual has also just successfully led the organization through a multi-year reorganization, resulting in a substantial improvement in both service delivery and financial position.

As noted in the best practices section of this report, a board should first obtain adequate comparability data in setting a reasonable compensation for its executive. This process would include reviewing agencies similar in size and type and in geographic location. Looking at data similar to the Commission's data (see chart on p.13), for similar-sized agencies (annual revenues of $15 million to $25 million) in New York City and the Long Island region, the committee would find that the median compensation for executive directors, in this case, would be $208,300 with the 25th and 75th percentiles of $171,600 and $280,400 respectively.[17] The median years of service in the position would be 15 years (see chart on p.17).

> It is important for a board to be able to clearly articulate and document why it set the individual's compensation where it did.

In this example, when evaluating the information, the board should first note that the agency is at the low end of the revenue range of comparable agencies and its executive director's tenure of three years in title is well below the median of 15. These factors could be used to justify a compensation package somewhere in the lower end of the range of the comparable data. However, the committee should also look closely at the individual's performance. Outstanding performance or significant accomplishments of an individual would be factors which could justify a compensation amount in

[17] Because the survey data reflects compensation reported for 2006, the board of directors or compensation committee may wish to trend these figures forward using a reasonable cost of living factor.

the mid to high-end range. Other factors that might also be considered by the committee are the individual's education level and overall experience which, in this case, are both on par with most executive directors in the field. It is important to note that there is no mathematical formula to determine where in the range of data an executive should fall. What is important is that a board be able to clearly articulate and document why it set the individual's compensation where it did. Obviously, as compensation levels move higher, boards should have stronger evidence supporting their decision.

After considering the above factors, the committee may feel that the executive director's outstanding performance balanced against the smaller size of the agency justifies a compensation package near the median for comparable agencies and recommends the following to the full board for approval:

Annual Salary	$150,000
Deferred Compensation	30,000
Health Insurance	10,000
Life Insurance	5,000
Expense Account	5,000
Total	$200,000

Note that the compensation package includes all of the benefits to be received by the executive director and not just the annual salary. In this instance, these benefits account for 25 percent of the total compensation.

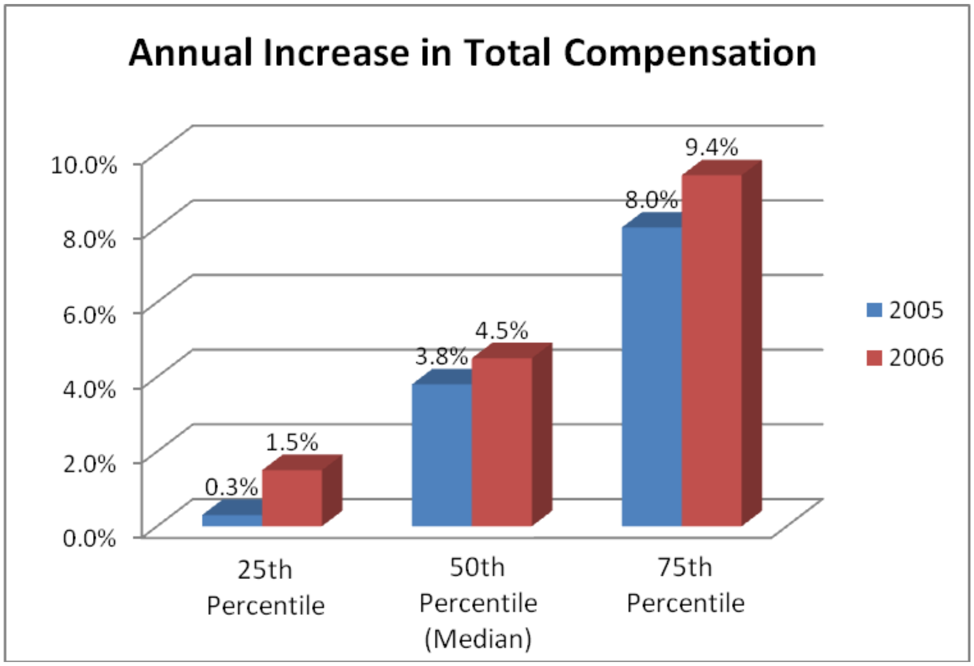
Once presented to the full board, the related deliberations and votes should be documented in the minutes. Such documentation should include the name of each board member and their individual vote. Also, any board member who has a conflict of interest or is not a disinterested party must not be present for any deliberations or vote relating to compensation. Finally, all comparability data and other information relied on in setting executive compensation should be retained.

While this example is very simple, it illustrates some of the steps not-for-profit agencies can take to ensure that executive compensation is set at reasonable levels. Many other factors could be considered when setting executive compensation, including but not limited to the economic climate, current salary and the size of any proposed increase, and the reactions of donors, funding sources or other stakeholders. Other sources of comparability data also exist. What is important to remember is that boards of directors must independently set executive compensation levels based on objective, meaningful data and document the results.

ADDITIONAL INFORMATION

1. Pay Increases

The annual percentage increases in CEO compensation were reviewed as part of this study. The median annual increase was about 4 percent for both 2005 and 2006; however, there was considerable variation in the raises. The following chart depicts the percentage increases for the median as well as the 25th and 75th percentiles.



The Commission recommends that boards establish measures to ensure there is appropriate justification, which is based on the business needs of the agency, when executives receive pay increases which exceed across-the-board pay increases for all agency employees.

2. Compensation of Other Executive Level Employees

Despite an emphasis on board approval of CEO compensation, the IRS intermediate sanctions can be applied to any key employee, meaning any person in a position to exercise substantial influence over the organization. The Commission's survey requested compensation information on other executive employees besides the CEO/executive director. A review of this data found widespread variability, not only in the compensation amounts but also in the job titles for those employees. Overall, most of these individuals were paid significantly less than their respective executive director. When comparing the executive director compensation to the next highest paid employee, the median differential was pay at about 30 percent less than the CEO. Nevertheless, boards of directors should consider undertaking compensation evaluations not only for the CEO but also for other key employees.

3. Gender

A common research topic in compensation studies is the question of whether a gender gap in earnings exists. At the 658 agencies analyzed by the Commission, the median compensation for women executive directors was $96,000 versus $135,000 for men. However, the Commission's statistical analysis showed that when considering the factors that influence compensation, particularly agency revenue, there was no significant difference in pay levels. Thus, the disparity in median compensation appears to be explained by the fact that the agencies run by women tended to be smaller. Women led 50 percent of the agencies with annual revenues below $16 million, but only 27 percent of the agencies with annual revenues of $16 million or more.

4. Accuracy of Self-Reported Data

The Commission conducted site visits to 31 agencies as part of this study to determine the accuracy of the compensation figures reported on the survey. The visits included an examination of W-2s and other underlying records pertaining to the self-reported compensation figures. The Commission found that although discrepancies existed in two-thirds of the agencies reviewed, for the most part the self-reported figures were reasonably accurate. Most of the discrepancies were small; about three-quarters of the agencies had errors of less than 4 percent. Four of the 31 agencies had errors in excess of 15 percent, but overall they tended to balance each other out, with some over-reporting and others under-reporting the compensation.

The Commission site visits also examined the compensation reported on the IRS Form 990s and on the NY State Consolidated Fiscal Reports. Like the self-reported survey figures, the discrepancies and errors tended to be small and counterbalancing. Given that compensation surveys inherently rely on self-reported data, and the possibility of error is always present, it is clearly a best practice to utilize data from a larger sample size, rather than placing heavy reliance on a few data points or especially on just one comparable. In this way, the chance of being influenced by incorrect data is minimized.

5. IRS Form 990 – A Source for Comparable Data

The IRS Form 990 is the most common source of public information on executive compensation at not-for-profit corporations (see *www.guidestar.org*). For decades, the Form 990 has included disclosure of compensation for officers, directors, trustees and key employees. Beginning with filings in 2009 (for the 2008 tax year), the entire form was redesigned because, according to the IRS, it needed to be updated to take into account "significant change in virtually all aspects of operations" of the tax-exempt sector since the form was last overhauled 30 years ago. The redesigned form has three major goals: to enhance transparency by providing a realistic picture of the organization and its operations along with a basis for comparing the organization to similar organizations; to promote compliance by requiring organizations to accurately reflect the organizations' operations and use of assets; and to minimize the burden on organizations filing.

The revised form significantly expands the information required to be reported regarding executive compensation and now includes governance disclosures such as whether a compensation survey or study was conducted to establish the compensation, whether a compensation committee was involved, and whether a review and approval was conducted by independent persons with contemporaneous substantiation of the deliberation and decision. The best practices presented in this report took into consideration the IRS governance disclosures.

The Form 990 revisions are also expected to generate more consistent and accurate data. For example, the new form requires that compensation amounts agree with calendar year wage reports filed with the IRS and the form is now accompanied by much more detailed instructions listing out many benefits by name, such as health benefit plan premiums. Considering that the Commission's site visits noted several providers failed to report health insurance benefits, the detailed listing of benefits in the instructions may lead to more all-inclusive reporting.

The IRS has also added a disclosure to address cases where its reporting requirements have led to double counting of the same benefit, once when it is first earned and again in later years when it gets reported as a taxable payment. Double reporting occurred at two agencies in the Commission's survey when non-qualified deferred compensation that was earned over a number of years was again reported all at once in the year it became taxable due to vesting (see discussion on p.17). Such double counting can make the compensation appear much higher than actual. The new disclosure on the revised Form 990 addresses this problem as illustrated in the following example:

Identifying Double Counted Compensation on the Revised Form 990

Schedule J (Form 990) 2008 — Page 2

Part II — Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees. Use Schedule J-1 if additional space is needed.

For each individual whose compensation must be reported in Schedule J, report compensation from the organization on row (i) and from related organizations, described in the instructions, on row (ii). Do not list any individuals that are not listed on Form 990, Part VII.

Note. The sum of columns (B)(i)–(iii) must equal the applicable column (D) or column (E) amounts on Form 990, Part VII, line 1a.

(A) Name		(B) Breakdown of W-2 and/or 1099-MISC compensation (i) Base compensation	(ii) Bonus & incentive compensation	(iii) Other reportable compensation	(C) Deferred compensation	(D) Nontaxable benefits	(E) Total of columns (B)(i)–(D)	(F) Compensation reported in prior Form 990 or Form 990-EZ
JANE DOE	(i)	350,000	0	600,000	30,000	20,000	1,000,000	600,000
	(ii)							

Total Compensation Reported	**$ 1,000,000**
Compensation Reported Previously ***(Double Counted)***	**600,000**
Net Amount Pertaining to Current Year	**$ 400,000**

Note: This schedule is required to be filed for executives with total compensation exceeding $150,000. CEO compensation is also reported on Part VII of Form 990 regardless of the amount. For executives with compensation below $150,000, narrative supplemental information on double counted compensation may be supplied on Schedule O.

Finally, the revised Form 990 now requires disclosure as to whether the form was provided to the board before it was filed, and requires a description of the process used by the board to review the form. Therefore, it is important that board members have an understanding of the compensation data being presented. Such an understanding is helpful not only for members reviewing their own organization's filing, but also in cases where the members are relying on other agency filings as a source for comparable data.

6. Deferred Compensation and Retirement Plans

Other than salary, deferred compensation and retirement plan contributions accounted for the largest components of executive director compensation. Two-thirds of agencies reported one or both of these types of benefits. The average annual retirement plan contribution was just over $10,000 at the 383 agencies reporting this type of benefit. The average annual salary deferral at the 134 agencies reporting deferred compensation plans was approximately $27,700.[18] Many of the deferred compensation plans were 457(f) plans,[19] which allow not-for-profit corporations to supplement the retirement income of highly-compensated employees. The 457(f) plan is also referred to as a "golden handcuff" because, while the contribution rules are extremely generous (the contribution by an employer is unlimited), there is a risk of forfeiture if the executive leaves the agency prior to retirement. For some executive directors, deferred compensation exceeded $100,000 per year, accounting for a significant portion of their total compensation. The varying levels of such benefits illustrates why it is important for boards to identify and include all forms of compensation in its analysis of executive pay.

7. Personal Use of an Employer-Provided Automobile

A popular benefit provided to many executives was the use of an employer-provided automobile. More than one-third or 224 executive directors reported receiving this benefit. The type of vehicle provided ran the gamut from older, more modest vehicles such as a 1996 Dodge Caravan, to newer, luxury vehicles such as a 2005 Jaguar or 2007 BMW. According to IRS rules, there are three methods for determining the value of this benefit – Lease Value Rule, Cents-Per-Mile Rule and Commuting Rule. In most cases, however, only one method - the Lease Value Rule - is appropriate for the agencies responding to the survey.[20] The Commission found that while agencies reported an amount reflecting the value of the use of employer provided automobiles on the executives' W-2, in 44 percent of the cases reviewed, errors were made in the amount reported.

---

[18] The annual deferred compensation amounts described in this section of the report do not include vesting payouts previously discussed on p.23.

[19] A 457 plan is a retirement plan authorized under Section 457 of the Internal Revenue Code. Employees participating in 457 plans are allowed to defer their compensation on a before-tax basis. A 457(f) plan is a non-qualified deferred compensation arrangement between the employer and employee and is more restrictive than other retirement plans. The funds placed into a 457(f) plan remain the property of the employer and are subject to "substantial risk of forfeiture" and therefore are available to creditors.

[20] The other two methods, the Cents-Per-Mile Rule and the Commuting Rule, do not apply for several reasons. For instance, the Cents-Per-Mile Rule is applicable only to vehicles valued at less than $15,000 when it was first made available to the employee. This amount would exclude most of the vehicles reported in the Commission's survey.

Appendix 1

SUMMARY OF SURVEY DATA - QUICK FACTS

(n=658)

General Data

- The revenue reported by the 658 agencies totaled close to $9 billion
- The median revenue of the agencies was $6.3 million
- The agencies employed about 180,000 individuals
- The median number of employees employed by the agencies was 132
- 3 percent of CEO workweeks were less than 35 hours, 24 percent were greater than 45 hours
- The median tenure for a CEO was 12 years
- The median number of years in the field of a CEO was 28 years
- 44 percent of CEOs were women
- 54 percent of CEOs had master's degrees, an additional 11 percent had doctorates

CEO Compensation Data

- Approximately $96 million represented CEO compensation at the 658 agencies
- 85 percent of CEO compensation was in the form of a salary
- $15 million covered various benefits other than salary
- 67 percent of CEOs had a deferred compensation plan and/or a retirement plan
- 42 percent reported welfare-benefits (e.g., life, health, disability insurance)
- 34 percent of the agencies provided an automobile for their CEO
- The median compensation for the chief executive was $117,000

Data Related to Board Governance

- 95 percent of boards approved the CEO's compensation
- 79 percent documented approval in the board minutes
- 58 percent of the boards had a compensation committee
- 70 percent of the boards/committees used comparable data
- 38 percent of CEOs had a written employment contract