



Good Governance Practices for Health Care, Educational & Other Non-Profit Organizations



Compensation of Non-Profit Directors in Massachusetts:

“You Can Pay Me Now...”

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Selected Expectations Regarding Director Compensation

- A successful charity pays no more than reasonable compensation for services rendered. **Charities should generally not compensate persons for service on the board of directors except to reimburse direct expenses of such service.** Director compensation should be allowed only when determined appropriate by a committee composed of persons who are not compensated by the charity and have no financial interest in the determination.

Source: IRS "Good Governance Practices For 501(c)(3) Organizations" (Draft 2007 no longer available on IRS website, available at www.aetr.org/downloads/GoodGovernancePractices.pdf) (Emphasis added.)

- **A substantial majority of the board of a public charity, usually meaning at least two-thirds of the members, should be independent. Independent members should not:** (1) be compensated by the organization as employees or independent contractors; (2) have their compensation determined by individuals who are compensated by the organization; (3) **receive, directly or indirectly, material financial benefits from the organization** except as a member of the charitable class served by the organization; or (4) be related to anyone described above (as a spouse, sibling, parent or child), or reside with any person so described.

Source: *Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations*, Panel on the Nonprofit Sector (October 2007)

www.independentsector.org/uploads/Accountability_Documents/Principles_for_Good_Governance_and_Ethical_Practice.pdf

(Emphasis added.)

Different Expectations Regarding Director Compensation

- Although the Internal Revenue Code **does not require charities to follow a particular process in determining the amount of compensation to pay**, the compensation of officers, **directors**, trustees, key employees, and others in a position to exercise substantial influence over the affairs of the charity should be determined by persons who are knowledgeable in compensation matters and who have no financial interest in the determination.

Source: IRS "Governance and Related Topics - 501(c)(3) Organizations" (2008, available at www.irs.gov/pub/irs-tege/governance_practices.pdf) (Emphasis added.)

- A corporation may pay compensation, including pensions, in a reasonable amount to its members, directors, or officers for services rendered

Source: Section 29-301.27 of the District of Columbia Nonprofit Corporation Act

Studies Suggest Non-Profit Board Compensation Is Rare

- In one study, nonprofits only 2% reported compensating board members.
- This percentage was higher among larger nonprofits, reaching a high of 10% among nonprofits with over \$40 million in expenses.
- The propensity to compensate was also higher among health organizations (4%) than nonprofits in other fields (2%).

Source: *Nonprofit Governance in the United States*, 2007, The Urban Institute p. 11, <http://www.urban.org/publications/411479.html>

Factors Arguing Against Compensation for Non-Profit Board Members:

- Board members are generally perceived as volunteers
- If the non-profit has donors or members, they expect their monies to be spent on services
- Many nonprofits are organized and operated to serve a mission
- Boards that pay members could discourage the act of volunteering
- Boards that pay members could discourage charitable giving
- Boards have the fiduciary responsibility of managing the organizations' funds
- Boards that pay board members could be considered more like staff
- Boards might lose the protective status of the Volunteer Protection Act

Source: ASEA

Factors Arguing for Compensation of Non-Profit Board Members:

- Promotes economic diversity, giving members an opportunity to serve who might otherwise be unable to do so
- Attracts the most qualified and able individuals
- Promotes professionalism rather than enthusiastic amateurs
- Awards in a tangible way valuable personal time and contributions made for the cause
- Promotes more risk-taking
- Stimulates better attendance at board and committee meetings
- Allows the board to hold board members more accountable for performance

Source: ASEA

How Massachusetts Got Where We Are: A Timeline of Mass. AG Activity

- Non-profit director compensation is still legal in Massachusetts, but it has been under significant scrutiny for several years:
 - December 5, 2007 letter from David G. Spackman to Citi Performing Arts Center, Inc.
 - September 2, 2009 memo from David G. Spackman to Harvard Pilgrim, Fallon, Tufts Health Plan and Blue Cross Blue Shield of Massachusetts
 - April 14, 2011 letter from David G. Spackman to Chairs of Harvard Pilgrim, Fallon, Tufts Health Plan and Blue Cross Blue Shield of Massachusetts.

Issues of Concern for the Mass. AG

From the 2007 Citi letter:

- Direct or indirect payments to these persons or firms, if in amounts in excess of fair market value for the services rendered, could constitute a breach of trust in the administration of charitable funds.
- What constitutes fair market value for personal or professional service arrangements, such as the ones addressed herein, are among the most difficult issues that boards and regulators must address.
 - While the use of market comparables is appropriate and helpful, the wide range of evidentiary factors available and the intrinsically unique characteristics of such services, means that identifying precise comparables is difficult.
 - As a result the [Public Charities] Division is guided by criteria and procedures similar to those employed by the Internal Revenue Service pursuant to its so-called Intermediate Sanction Regulations (see Reg. §53.4958-6C), which look to the process utilized by the charitable entity in establishing the amount paid.
 - More specifically we look for evidence of: (i) governing body involvement; (ii) use of independent sources of information and advice; (iii) lack of undue influence exerted by the compensated person; (iv) disclosure; and (v) concurrent documentation.

Mass. AG's 2009 Investigation and Report

- The Attorney General's report is the result of an investigation launched in 2009 into executive and director compensation at Massachusetts nonprofit health insurers.
- This report expresses concern that compensation of independent directors at public charities raises conflicts of interest, and is antithetical to a charitable mission.
- The report challenges the arguments made by the health insurers attempting to justify their director compensation practices, finding no evidence to support those arguments.

April 2011 Mass. AG Report

- In April 2011, the Public Charities Division of the Office of the Attorney General issued a report on non-profit board compensation.
- It again focused on large, state-wide health insurance companies. That report outlined two steps that the Attorney General will take to limit – but not explicitly ban – independent director compensation at public charities:
 - Requiring annual statements setting forth the rationale for director compensation; and
 - Filing legislation to prohibit director compensation “without proper oversight.”

Pending Massachusetts Legislation

- Attorney General Coakley and others have offered legislation that might change the existing Massachusetts rules in regard to non-profit director compensation.
 - For example, the Attorney General has filed legislation that will require public charities to obtain the Attorney General’s approval before compensating their independent (non-employee) directors and officers. According to the report, the Attorney General wants to ensure that public charities base their compensation decisions on a “clear and convincing rationale.”
 - Also, proposed Senate Amendments would allow the Attorney General to review non-profit director compensation and have the potential to bar on board member compensation. It would provide that:
 - State Senator Mark Montigny has added an amendment to a budget bill that would cap the compensation that could be paid by a public charity with over \$1 million of gross revenues at \$500,000.

H3516: An Act regulating compensation of board members for public charities

- **No Massachusetts based public charity ... shall provide compensation** to any independent officer, director or trustee for service as such independent officer, director or trustee **except with the approval of the Director in accordance with the provisions of this section.**
- Any such public charity intending to provide compensation to any independent officer, director or trustee **shall file an application with the Division ... requesting the approval of the Director to provide compensation.**
- The Director may adopt and promulgate ... the criteria for granting approval and the time period during which such approval shall be effective. Such criteria shall recognize that service ... is recognized as a voluntary contribution of time and expertise ... and **that any departure from the voluntary nature of such service requires a clear and convincing showing that compensation is necessary to enable the public charity to attract and retain experienced and competent individuals to serve as independent officers, directors or trustees.**

(Emphasis added.)

Appendix

- IRS Draft 2007 Good Governance Practices For 501(c)(3) Organizations
- IRS Governance and Related Topics - 501(c)(3) Organizations (2008)
- Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations, Panel on the Nonprofit Sector (October 2007)
- Nonprofit Governance in the United States, The Urban Institute (2007)
- December 5, 2007 letter from David G. Spackman, Chief: Non-Profit Organizations/Public Charities Division, Office of the Attorney General to Dr. John Poduska, Chairman of the Board, Citi Performing Arts Center, Inc.
- Press release, “Massachusetts Attorney General Martha Coakley Announces Enhanced Oversight of Non-Profit Executive and Board Compensation,” September 2, 2009
- September 2, 2009 memo from David G. Spackman, Chief: Non-Profit Organizations/Public Charities Division, Office of the Attorney General to Harvard Pilgrim, Fallon, Tufts Health Plan and Blue Cross Blue Shield of Massachusetts
- Press release, “AG Coakley Determines That Compensation of Board Members at Non-Profit Health Insurers is Not Justified,” April 14, 2011
- April 14, 2011 letter/report from David G. Spackman, Chief: Non-Profit Organizations/Public Charities Division, Office of the Attorney General to Chairs of Harvard Pilgrim, Fallon, Tufts Health Plan and Blue Cross Blue Shield of Massachusetts
- House No. 3516 “An Act regulating compensation of board members for public charities”
- October 6, 2011 letter from James Roosevelt to Chairman Eugene O’Flaherty re: H3516
- October 11, 2011 testimony of Michael W. Peregrine re: H3516