

Attorney General of Massachusetts Announces Initiative on Executive and Director Compensation

September 3, 2009

The compensation practices of nonprofit organizations in Massachusetts just became subject to increased scrutiny. The Non-Profit Organizations/Public Charities Division of the Office of the Attorney General of Massachusetts announced yesterday that it is turning its attention to compensation paid by health care systems and health care insurers to their executives and directors. Depending on the outcome of its investigation and new reporting requirements, the Division may expand its review to other sectors.

The Division expressed its concern that executive compensation levels have risen artificially in recent years, despite the enactment of “intermediate sanctions” rules and regulations under Internal Revenue Code Section 4958 several years ago. Under its authority to enforce the due application of charitable funds, the Division will increase its review of organization practices for setting executive compensation levels. The Division plans to require “significantly more expansive and robust reporting requirements for large health care organizations.” The Division will require calendar year reporting for all affected organizations by March 1 of the subsequent year, starting in 2010. Large health care organizations will need to report a variety of information, including, for example, the decision-making process and rationale for executive compensation and how performance bonuses “promote fiscal health and charitable mission.”

In addition to executive compensation, the Division is reviewing the practice at four health care insurers of compensating independent board members. The Division stated that because the practice is rare and may compromise a director’s independence, it requires “a clear and convincing case.”

The Division stated that its initial focus is on the health care sector, due in part to concerns about the rising costs of health care. The Division anticipates that it may expand its review and its reporting requirements to other nonprofit sectors. The broader implications are clear, however, even without the Division’s formal investigation of other sectors. It is evident from the initiative described yesterday [.pdf] that the Division is not sympathetic to high compensation established substantially in reliance on comparable compensation studies supplied by consultants. However, the Division explicitly acknowledged that nonprofit organizations draw executives from the commercial market and that the Division does not mean to substitute its judgment for that of active boards of directors. The Division expects an organization’s board of directors to be engaged and thoughtful in the process and in reaching its conclusion.

In light of this new initiative and prior guidance issued by the Division, as well as a broader concern nationally about executive compensation, all nonprofit organizations are well-advised to evaluate their processes and conclusions for executive and director compensation to determine whether such compensation is indeed fair and reasonable.

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