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Compensation Best Practices in the Nonprofit World - Part 5 in a Series

BUSINESS ADVISORS, COMPENSATION STUDIES, HEALTH CARE, HIGHER EDUCATION, NOT-FOR-PROFIT

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In this series that addresses common issues surrounding compensation, it's worthwhile to note that compensation encompasses all forms of pay and not simply base salary. Let's dive a little deeper into the different elements of compensation.

Base Salary

The one element common to all compensation packages, base salary makes up the majority of compensation in a typical pay package within the nonprofit sector. Therefore, it's important that base salary is set only after consideration of all relevant factors, such as comparable market data, review of the compensation philosophy, organization culture and norms, compensation history and the organization's available financial resources.

Bonus and Incentive Compensation

Bonus and incentive compensation in the nonprofit sector is most often seen in larger organizations, particularly within certain sectors like healthcare and media and other organizations that compete more frequently with the for-profit sector for talent. Incentive compensation is less prevalent in foundations and advocacy organizations.

Generally speaking, the use of incentive compensation is increasing in the nonprofit world since, when tied to measurable achievements and organizational objectives, it aligns executives' priorities with organizational priorities and provides motivation to achieve key goals of the entity. Another benefit of incentive compensation is that it allows the organization to align compensation with the market without committing to pay the entire amount in a fixed base salary. If the organization has a bad year, bonuses may not be paid. Additionally, annual salary increases can be smaller, reducing fixed costs over a long term.

When designing incentive compensation, be careful about calculating an award as a percentage of money raised. Incentives structured in this way are considered unethical by many nonprofits and may attract IRS scrutiny.

Another caution is to ensure that if incentive compensation is used, total compensation is still reasonable and does not create any issue with intermediate sanctions.

Deferred Compensation

Deferred compensation is the portion of an executive's salary that is paid at a future time. Outlined in the employment contract, this type of compensation is defined by the amount and timing, as well as any conditions like tenure or goal achievement necessary for payout. Another type of deferred compensation defers pay, tax free, until retirement or some vesting period. This can be an important element of the total compensation package as it can increase staff retention while also providing executives with post-retirement income. Deferred compensation can be complex and includes both liability and tax implications that should be discussed with legal counsel and your tax advisor.

Other Benefits and Perquisites

Nearly all nonprofit organizations provide health insurance benefits; many also provide some level of disability and life insurance. Other common benefits include memberships in professional organizations, annual physical exams, a car allowance and parking privileges. Less common, but sometimes included, are country club memberships, financial counseling, first-class air travel, spousal travel, excess liability insurance and long-term care insurance. These benefits may be a good fit for some organizations, depending on facts and circumstances.

The following benefits are applicable in specialized situations:

- Housing allowance (or low-interest or no-interest mortgage loans), maintenance and utilities are offered most commonly in the higher education sector and in organizations located in areas with high costs of living.
- Sabbaticals are most common in educational and religious organizations.
- An entertainment budget is most common at larger nonprofits where executives' duties may involve extensive networking.
- Tuition assistance is most common in higher education, but can be offered by other types of nonprofits as well.

Perquisites can be subjected to extra scrutiny by donors and others, so be sure they're not inappropriate or excessive from a legal standpoint, as well as from the perspective of the organization's culture, history and stakeholder expectations.

Once the board of directors considers the individual elements of a compensation package, they then must consider if the package is reasonable in its totality.

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