GETTING PERSONAL: IRS Questions Pay Of Charity Executives

By Shelly Banjo
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NEW YORK (Dow Jones)--The heat over executive compensation, centered lately on banks seeking government handouts, is spreading to the nonprofit world.

Hospital chiefs, charity directors, university presidents and other nonprofit executives are coming under closer scrutiny from federal regulators, legislators and donors as big pay packages seem more out of scale in a sharp economic downturn.

Hospitals represent the largest component of the tax-exempt sector, when measured by revenue and assets, and their top executives’ pay was questioned in a critical Internal Revenue Service report last week. The report also surveyed how nonprofit hospitals provided community benefit - a key to keeping tax-exempt status.

The average compensation paid to top executives of hospitals was $490,000, according to the IRS report. The IRS surveyed 489 nonprofit hospitals in a two-year study.

At 20 hospitals that the IRS had selected for further review because of relatively high pay, average compensation reached $1.4 million. At least one of the hospitals was providing excessive compensation, the agency said, but it declined to name any of the hospitals in the report.

The push for better accountability and more transparency from nonprofit institutions is not new, but has been strengthened in a time of shrinking endowments and donations. Several compensation and investment scandals have intensified the spotlight and increased donor mistrust, said Tim Cotter, a managing director at compensation consultancy firm Sullivan, Cotter and Associates, Inc.

"When key stakeholders perceive that compensation is out of touch," it can have a significant impact on donors, Cotter said.

Hundreds of nonprofit institutions, including charities and trusts, are said to be victims of the alleged $50 billion Ponzi scheme by financier Bernard Madoff. As a result, donors are asking whether the leaders of these institutions were careful enough in making investments.

In September, a compensation scandal around a $1.2 million pay package for Chief Executive Gloria Pace King caused the United Way of Central Carolinas Inc. to face a public relations nightmare, resulting in board member resignations and King's termination.

The salary was "predictably unacceptable" to many donors and volunteers, according to an independent governance review panel.

Federal tax rules mandate "intermediate sanctions," or penalty taxes, if a charity pays an excess benefit to a top executive - with the executive on the hook to pay the tax rather than the institution. Nonprofits often try to avoid penalties by using a "rebuttable presumption of reasonableness," a procedure including advance approval by the organization's board and using comparable salary data from similar companies to determine compensation.
As the IRS digs deeper into laws associated with nonprofit organizations, some consultants warn that charities could also face a revocation of the organization's tax-exempt status.

A number of nonprofits are beginning to reassess compensation and benefits, said Michael Peregrine, a partner in the Chicago office at the law firm of McDermott Will & Emery LLP.

Compensation experts say nonprofits are being more conservative with salary increases, as well as implementing salary freezes at struggling organizations. Other benefits and performance incentives may be held back for 2009.

Defenders of current pay levels say any push for more austere packages may make it harder for organizations to attract and retain top talent, especially at such organizations as hospitals and research facilities that compete with the private sector for employees.

Pay for top executives and research physicians at hospitals can reach into seven figures. For example, David N. Silvers, a clinical professor of dermatology at Columbia University, earned more than $4.3 million in total compensation for 2007, while Zev Rosenwaks, a professor of medicine at Cornell University, earned more than $3.1 million, and Harold Varmus, chief executive at the Memorial Sloan-Kettering Cancer Center in New York, earned more than $2.5 million, according to the Chronicle of Philanthropy's 2008 Executive Compensation Survey.

"Employees should get paid for the value they produce, whether that is social value" in the case of a nonprofit, or return "for shareholders at for-profit companies," said Sean Stannard-Stockton, principal and director of tactical philanthropy at Ensemble Capital Management.

Donors who are wary of their donations landing in executives’ pockets can check out how much chief executives are making at specific charities at charitynavigator.org, a charity watchdog group.

In 2008, more than 100 chief executives in Charity Navigator's database made more than $500,000. Eight CEOs earned more than $1 million, including the president of Johns Hopkins University, William R. Brody; the general manager of the Metropolitan Opera in New York, Peter Gelb; and Michael Kaiser, president of the John F. Kennedy Center for the Performing Arts in Washington.

Compensation experts say donors should also examine executive pay in a number of different contexts. The difference in pay across categories can be significant: Executives running education, health and arts-and-culture nonprofits can earn almost twice the amount earned at human services or environmental agencies.

"One of the indicators of whether or not a charity is truly in a position of service is getting a sense of what salaries are and how they compare" to executives serving at nonprofits of similar size and industry, says Charity Navigator President Ken Berger. Compensation is typically higher at nonprofits with larger staff and expenses. Organizations with total expenses greater than $13.5 million report above-average pay, according to Charity Navigator's study.

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