

Planning for Success: Key Factors for Nonprofit Executive Compensation

By Stan Reiff, Partner

Executive compensation is a complex issue for churches and ministries. While effective compensation packages help organizations attract and support talented, passionate employees, they must also meet IRS requirements and stand up to public scrutiny.

We recently discussed these issues with two industry thought leaders:

- Dr. Ben LeVan, Associate Professor of Business Administration at Charleston Southern University and Founder of PROPEL, an HR services consulting firm
- Ted R. Batson, Jr., Partner, Tax Counsel, and Professional Practice Leader – Tax at CapinCrouse

Their insight on nonprofit executive compensation best practices is below, along with information and helpful resources from [ECFA](#).

What is the greatest executive compensation risk ministries and churches face in today's environment?

Dr. LeVan: The biggest risk is not being proactive; not having a plan for compensation. Ministry and church leaders should be clear about what they hope to accomplish with their compensation packages, which will differ based on the business model. For example, a compensation package for a university president may look very different from one for a pastor. Compensation plans must examine internal and external equity to find the best alignment.

The main way to mitigate these risks is to have a documented plan that is updated annually.

Ted: I believe there are two significant risks that bookend the continuum of leadership compensation in a ministry or church. The first is failing to adequately compensate leaders and pastors, both in terms of financial remuneration and in terms of caring for their spiritual and emotional needs. The financial piece can be addressed by obtaining an adequate understanding of salaries paid to others in comparable situations. The spiritual and emotional element requires wisdom to create a benefits package that provides the desired results.

Leaders and pastors who are well-compensated are at the other end of the continuum. The risk here is when the ministry or church fails to ensure and document that the compensation package is in line with compensation paid to other similarly situated leaders or pastors. Given the increase in the number of mega-churches and the diverse ministries of those churches and their leadership, it makes sense that the leader's compensation would reflect his or her giftedness and the diversity of the ministry.

ECFA Resource: The ECFA article [Paying the Leader](#) outlines four situations that can cause others to question a ministry's compensation decisions:

1. Lack of independence
2. Lack of comparability
3. Failure to approve all compensation elements
4. The board being unaware of the leader's compensation

As the article notes:

Under federal law, compensation of leaders is limited to what is reasonable. While "reasonable" compensation depends on the facts of each situation, it generally means the amount that would be paid to other leaders providing similar services at similar organizations. The IRS may impose tax

penalties on those who receive excessive compensation and on those who approve excessive compensation in certain circumstances.

What are some best practices to mitigate these risks?

Dr. LeVan: The main way to mitigate these risks is to have a documented plan that is updated annually. This plan can include a compensation philosophy and specify the x-factor that will be the maximum difference between the highest- and lowest-paid employees. In the corporate world, this could be as much as 100x, but the highest compensation for a nonprofit executive should be 25x.

When hiring executives, it is so important for nonprofits to really get a sense of their heart and communicate with the executives throughout their employment to ensure that they feel supported. Another way to support your leaders is to occasionally send notes to their family members to thank them for their sacrifice.

Ted: For the financial elements of compensation, as I noted, ministries and churches should obtain an understanding of the compensation paid to other similarly situated leaders to ensure that what they are paying their leaders or pastors is in line with the community. Where the compensation is more than what is paid to other similarly situated leaders or pastors, the organization should document why this may nonetheless be reasonable.

For the spiritual and emotional aspects, ministries and churches should reflect on the need for leaders to have their own pastoral care, ministry and leadership coaching, marriage affirmation, and other similar non-financial elements as part of their compensation.

ECFA Resource: ECFA has Seven Standards of Responsible Stewardship™, drawn from Scripture, that ECFA-accredited ministries are committed to upholding. [ECFA Standard 6 - Compensation-Setting and Related-Party Transactions](#) states, in part, that:

Every organization should exercise care and diligence in setting compensation and benefits to ensure that total compensation of its top leader and all of its employees is reasonable, taking into consideration the skills, talents, education, experience, performance, and knowledge of the person whose compensation is being set.

These guidelines can help you create a compensation policy that outlines the vision of your organization and how compensation fits into that overall philosophy.

Why should organizations consider hiring a professional compensation consultant to help determine appropriate compensation when they can purchase some books on the topic?

Dr. LeVan: This is similar to hiring an auto mechanic. Are you planning to do preventive maintenance on your vehicle? How big is the issue? If your transmission needs fixing, you'll probably need some expertise.

Small ministries can ask around their networks to get a sense of what others are doing in terms of total compensation — elements beyond basic salary, such as health benefits, housing, perks, and recognitions.

For larger organizations with hundreds or thousands of employees, it's recommended that you contract with a salary survey organization that can give you information specific to your location and your type of ministry.

Ted: A good compensation survey with an adequate description of the individuals represented in the survey may legitimately meet the needs of many ministries and churches. But the more complex an organization is, and the less “cookie-cutter” its activities are when compared with its peers, the less useful such surveys are. They may form a foundation for setting compensation in the absence of anything else, but they are unlikely to satisfactorily address ministry and leadership distinctions that may be relevant to the process.

What are some appropriate incentives for recruiting senior leaders without exceeding the budget or over-compensating the position?

Dr. LeVan: Be sure to do your homework to get an idea of what a reasonable compensation package is so you're not overcompensating, unless that is your strategy. When your budget is tight, think about items that are low-cost, no-cost, or tax-friendly. Can you take advantage of a 403(b) plan that will help maximize your compensation

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dollars? What about your health care plans or vacation time?

Understanding what matters most to the leader is also helpful, particularly considering that intrinsic compensation generally is more effective than extrinsic compensation. Would they like networking opportunities that the organization can pay for, such as attending conferences or joining professional organizations? If leaders will be traveling frequently, perhaps they would like the organization to pay for their spouse to travel with them from time to time. Some leaders want the flexibility to dictate the type of work environment and level of autonomy they will be allowed once they come on board, so having these discussions upfront could be very beneficial.

Ted: I agree with the suggestion to understand what energizes your senior leaders. Do you have a pastor who likes to write? Perhaps making sure he or she has the opportunity for two or three week-long writing retreats spread through the year would be meaningful. Does your leader have a passion for mentoring others? How can you feed that passion?

ECFA Resource: The article [Establishing Executive Compensation for your Ministry](#) includes questions to consider when exploring non-taxable compensation options for recruitment purposes, including:

- Do we want to base compensation upon performance?
- How do we treat our officers' honoraria?
- How often should we permit our officers to be away on travel?
- What about music or publications produced "on company time"?
- Are we avoiding unreasonable compensation and intermediate sanctions from the IRS?

What are some creative strategies and tools to incentivize senior leader retention?

Ted: Certain types of benefits have built-in retention elements. For example, nonqualified deferred compensation plans typically include vesting schedules that require employment beyond a certain number of years. Split-dollar life insurance arrangements can do the same thing.

One of the main retention tools used by ministries and churches is an objective bonus structure. The word

"bonus" can mean different things to different people. Inserting the word "objective" into the mix tends to lead toward creating a structure that has identified, measurable, and achievable targets that do one of two things: they reward greater production or shape behavior. Sometimes, they may do both.

This doesn't necessarily mean that a ministry leader or pastor worked smarter or more efficiently. (In fact, the ministry leader or pastor might be incentivized to work less efficiently.) Nor does it mean that he or she increased constituent impact, produced higher-quality output, or any one of several other laudable objectives. Rather, the organization has essentially told the ministry leader or pastor that it will make sure he or she is rewarded for giving the organization more than the baseline amount of time. However, when organizations concentrate on other achievements like quality, customer satisfaction, and efficiency, they have to work to identify "objective" measures for each of these outcomes that may, in turn, have unintended incentives.

So to me, the starting question is determining what behaviors or outcomes the organization wants to reward, and then what measurable markers it will use to determine success. How might the markers the organization measures reduce the risk of unintended incentives?

Another consideration is whether the objective markers you select are biased toward one portion of the workforce over another. For example, if flexibility in work schedules is essential to achieve a measurable marker, would this be a disadvantage for a parent with children, particularly a single parent?

Dr. LeVan: As I mentioned earlier, funding networking opportunities can be beneficial in that leaders treasure these connections. Creating loan-grant opportunities is another way to keep individuals committed to the organization. Providing autonomy and creating a supportive environment are also great ways to influence retention. What's most important, however, is staying connected with leaders by creating a family through a shared sense of purpose.

What are some tools organizations can use in designing a deferred compensation strategy for senior leaders?

Dr. LeVan: This is like my transmission analogy. I would strongly suggest working with a consultant who is experienced at designing deferred compensation plans,

which have tax implications. A consultant can help you think through all the considerations, such as whether you will include health benefits, insurance, and other perks.

Ted: As with bonuses, it's essential to understand the objectives of a deferred compensation program. For example, is the goal to simply minimize current income taxation by deferring the receipt of compensation to a later date, when the employee might be in a lower income tax bracket? Is the objective to provide supplemental retirement income to encourage retention, ensure adequate retirement funding, and otherwise compensate the executive? Or something else?

Regardless of the objective, there are a few avenues to consider:

1. A nonqualified deferred compensation plan with a complementary rabbi trust (consult with your auditor to ensure proper accounting and reporting)
2. Enhanced health insurance benefits (may currently be taxable)
3. Disability benefits or enhanced disability benefits (may currently be taxable)
4. Long-term care insurance (may currently be taxable)
5. Educational benefits (may currently be taxable)
6. Life insurance arrangements, such as a split-dollar plan (may currently be taxable)
7. Incentive compensation agreements tied to achieving organizational objectives
8. Opportunities for personal/professional development (education, participation in professional organizations and societies, freedom to engage in leadership of trade organizations, etc.)
9. Sabbaticals
10. Executive coaching/mentorship opportunities

Strategies for Success

There are many components to effective executive compensation, and we hope these best practices will help you consider your organization's specific situation and approach. Careful strategic planning can enable your organization to attract and retain talented, dedicated leaders and pastors while protecting your organization from IRS penalties and maintaining public trust.

If you'd like assistance with this process, we offer an [Executive Compensation Study](#) to help you navigate the complexities of executive compensation requirements. Please [contact us](#) to learn more about how we can help.

Additional Resources:

[Four Questions to Ask About Executive Compensation at Your Organization](#)

[Managing Compensation in The 'New Normal' Essentials of Compensating Ministry Leaders](#)

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Stan's professional experience includes over 35 years in ministry operations, public accounting, government accounting, and missions. He provides strategic leadership of the firm's professional advisory and consulting services, including research of emerging issues in the faith-based nonprofit sector and the development and implementation of products and services in response to those needs.

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