



Williams Overman Pierce, LLP  
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# “Are We Having Those Good Seafood Salad Sandwiches for Lunch Again?”

## The (Real) Questions Committees Should Ask About Executive Compensation

By Michael Conover

**That is an actual, and the only, question** from a compensation committee member after an hour-long presentation of an analysis presented to highlight serious problems with a proposed compensation arrangement for the organization's CEO. There were more attorneys in the room than board members as a controversial, sure-to-be-litigated, pay plan was considered. Detailed reports were circulated in advance and the issues were spotlighted in the presentation.

“Any questions?” I asked. That was it – the question about lunch was the only one asked. The proposal was approved and litigation commenced shortly thereafter.

Subsequent testimony revealed that the committee member in question claimed not to be an expert in compensation, relying instead on the CEO's endorsement of the proposal. When asked about the consultant report, the committee member admitted he thought he “glanced over it” prior to the meeting.

### My point here?

I regularly encounter situations with board/compensation committee members of tax-exempt organizations who appear to be just as “detached” as the salad-loving committee member of the above-mentioned publicly traded company. These situations involve board members who failed to request independent compensation analyses, never thoroughly read those reports, and/or never asked a follow-up question. For example:

- Two different consulting firms prepared an analysis of the compensation for the organization's CEO over a four-year period. Neither report included comparable organizations from the human services field in the data used to develop their competitive compensation range for the CEO. Instead, data from trade associations (whose roles are demonstrably higher paid than human services) was used.
- An organization requested an independent analysis of competitive compensation for a newly created senior-level position. A consultant prepared the analysis based on the job title alone and the assumption that it would be the average of the top two or three positions

reporting to competitor CEOs. Based on competitor pay data for positions almost certainly not similar to the newly created position (based solely on the title), a competitive compensation range was presented that could hardly be described as objective.

- A report prepared for a major, global NGO presented competitive compensation ranges for each of the organization's most senior-level executives. The report provided no names or information on any of the organizations included in the analysis, citing “confidentiality” concerns. Without any information on the size and scope of organizations included in the study, there was no basis for determining whether or not the compensation discussed in the report represented organizations that were comparable in terms of the IRS' rebuttable presumption of reasonableness.

In each of these instances, board members were provided with reports that never prompted a follow-up question, despite some rather questionable analyses and conclusions. For some reason, board members were unwilling or unable to ask a question that would determine whether the information was useful or useless as a context for the pay decisions facing the governing body.

Internal Revenue Service (IRS) Intermediate Sanctions make it clear that the board may rely on a qualified compensation advisor/valuation expert (Regs. § 53.4958-1(d)(4)(iii)). However, that does not relieve individuals of the responsibility to take the necessary steps to inform themselves about the decision before them as well as any information provided to them related to the topic at hand. Meetings of governing boards or their committees



are not intended to be simply a chorus chanting “Do we have a motion?” “Is there a second to the motion?” or “All those in favor say ‘aye’”.

Any compensation analysis presented to the board for Intermediate Sanctions purposes should readily be able to satisfy the following criteria:

- The distinguishing characteristics of the subject organization and each of the positions included in the report are clearly identified. For example:
  - Type of organization/service area(s)
  - Size and scope of the organization (e.g., annual revenue, operating budget, assets, number of employees, other pertinent operational measures)
  - Key responsibilities/accountabilities of the study positions, not simply job titles, and any other pertinent information (e.g., special certifications, years of experience) along with any distinguishing characteristic(s) of a particular position that might distinguish it from a typical benchmark to which it might be compared (e.g., a responsibility added to the position not usually associated with it or responsibility missing from the position that is usually associated with it).
- The criteria used for selecting the organizations/types of organizations and positions that will be used for the competitive analysis. These criteria should be closely based upon and/or resemble the characteristics describing the above-mentioned subject organization and position(s) being studied, more specifically:
  - Same or related types of organizations
  - Appropriately “bracketed” by a group of somewhat smaller and larger sized organizations to obtain an adequate sample for a valid analysis
  - Comparable position(s) based on job role rather than just position title
  - Significant differences noted between subject and benchmark organization(s)/position(s) noted and the implications explained
- The data analysis should be presented and explained in sufficient detail to support the conclusions reached. Supporting information should be made available in appendix exhibits that present ample evidence of the scope of data supporting the conclusions.

Any report used for support of compensation decision making should be distributed well enough in advance of the meeting to allow it to be reviewed by committee members and for questions to be prepared for the meeting. It is hard to imagine that it would not be possible for each person to arrive with a prepared list of questions about the report and/or its implications on the compensation.

Finally, the individual chairing the meeting or phone call should make a point of asking if members have any questions about the report or the decision prior to proposing any specific proposal for action or a vote upon it. Everyone needs to make an informed decision.

No questions about lunch until business is finished!