# WHAT BOARDS AND EXECUTIVES NEED TO KNOW ABOUT REASONABLE COMPENSATION

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*This information is provided by Ask CMF, a technical assistance service of the Council of Michigan Foundations, for educational purposes only and does not constitute legal advice.*

Board members and staff of philanthropic institutions regularly reach out to CMF to discuss best practice in determining reasonable compensation. The determination of compensation can be closely connected to organization values, including a commitment to fair and equitable pay. The issue of compensation also faces significant oversight by the IRS, in addition to potential scrutiny by news media and members of the public.

Determining reasonable compensation is an essential activity within staffed foundations. In fact, one of the required roles of a foundation's board is to evaluate the executive director's professional performance and approve their compensation. As such, the IRS has recommended procedures when a philanthropic institution is determining the compensation of officers, directors, trustees and other highest-compensated employees, as well as highest-compensated independent contractors.

This resource outlines recommended and required elements of this process, the details of a compensation package, special considerations in considering raises and bonuses, and much more.

*The "What Boards and Executives Need to Know" series of resources is designed to address questions of interest to board members and senior leaders of grantmaking organizations. These resources may be particularly useful for orientations, board trainings and general professional development and provide better understanding of key concepts that are necessary for the success of the governance and management of foundations in the field.*

# Table of Contents

## External Expertise

Determining appropriate levels of compensation can be a challenging element of a foundation's human resource activities recognizing the complexity of compensation and the many factors that can be considered in making such determinations. It is not uncommon for organizations to hire external experts to assist in that determination, particularly in periods of significant staff transition.

### Executive Search Firms

Foundations frequently evaluate appropriate levels of compensation during the search process for key staff positions. When working with an executive search firm or other form of HR consultant, these groups can facilitate the gathering of compensation data from comparable and peer organizations. Their experience in the field can provide important insights into the types of compensation appropriate to key positions, as well as how to structure an attractive compensation package for top-level candidates.

### Compensation Consultant

Compensation consultants are a specialized form of HR consulting firm with experience in determining appropriate compensation for either select positions or an organization's entire staff. These firms typically have access to data and processes that extend well beyond the resources of most search firms and HR professionals.

Compensation consultants are among the qualified professionals in the field who also have the expertise to provide an official opinion letter for the IRS. This is important to note because an IRS opinion letter will likely be required in any situation in which a foundation has compensation for an individual position set at the 75th percentile or higher based on comparable compensation data. These letters are of particular importance in situations where compensation could be considered "excessive," yet are informed by comparable data from the field.

## Determining Reasonable Compensation

State law generally prohibits nonprofit corporations from issuing dividends or otherwise sharing income with private individuals or entities. Further, the Internal Revenue Code prohibits charitable organizations (both public charities and private foundations) from using their assets to benefit private individuals (or entities) other than the charitable class the organization is intended to serve. This prohibition is called "private inurement" – a term that refers to situations where insiders of the organization are unduly benefiting from the charitable assets – and "private benefit" if independent third parties are the ones benefiting.[1] These prohibitions require that any compensation paid (to employees or to vendors for services) must be reasonable. Compensation of certain people is publicly disclosed on the IRS Form 990/990-PF. On this same form, organizations are required to describe the process for determining executive compensation.

[1] For more information, see https://boardsource.org/resources/private-benefit-private-inurement-self-dealing/.

It is worth noting that private foundations are subject to additional restrictions prohibiting payments to Disqualified Persons.[2] Foundations are permitted to provide reasonable compensation to Disqualified Persons for personal services (professional and managerial) considered to be "reasonable and necessary" to carrying out the exempt/charitable purposes of the organization. The IRS defines reasonable compensation as the value that would ordinarily be paid for like services by like enterprises under like circumstances. Reasonableness is determined based on all the facts and circumstances.

> Example: *In one actual ruling by the IRS, it was determined that compensation that was 75% higher than average for private foundations of comparable size (but not outside of the range) was excessive because it represented more than one-third of the foundation's grant expense.*

Compensation includes all forms of income and other benefits earned or received from the organization in return for services rendered such as salary, auto or club allowances, pension plan contributions and accruals, and other employee benefits, but it does not include reimbursement for valid business expenses.[3] Compensation of disqualified persons (or, in the case of private foundations, Disqualified Persons as previously defined), is subject to heightened scrutiny.

### Process for Determining Compensation

Some foundations choose to implement a policy for determining and approving compensation, particularly for executive positions. This may take the form of an "executive compensation philosophy statement," which outlines the organization's approach to determining compensation, particularly for key employees. This document provides an agreed-upon structure for setting compensation packages (including both salary and benefits), as well as the process to set compensation for new hires and to retain current employees through raises, bonuses and other options available to the organization. It is imperative that up-to-date documentation be kept on file, including job descriptions for each position and an organizational chart indicating the relative positioning of each job within the foundation.

If an organization meets the following requirements, the IRS will presume that payments it makes to a disqualified person under a compensation arrangement are reasonable. Although the IRS may still claim that the compensation is unreasonable, the presumption switches the burden of proof from the organization to the IRS.[4]

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[2] Section 4946 provides a list of disqualified persons with respect to a private foundation: (1) Substantial Contributors; (2) Foundation Managers; (3) Owner of more than 20 percent interest of certain organizations that are substantial contributors; (4) Family Members of persons described above (in 1-3); (5) Corporations in which persons described above (in 1-4) hold more than a 35 percent voting power; (6) Partnerships in which persons described above (in 1-4) hold more than a 35 percent profit interest; (7) Trusts or Estates in which persons described above (in 1-4) hold more than a 35 percent beneficial interest; (8) Certain Private Foundations which are effectively controlled by the person or persons in control of the foundation in question; and (9) Governmental Officials.

[3] Note that business travel expenses must also be considered reasonable. For more information, see CMF's resource, "What Boards and Executives Need to Know About Self-Dealing."

[4] Within the legal community, this may be described as a safe harbor that creates a rebuttable presumption. Practitioners may be more familiar with this concept being called "rebuttable presumption." For more information,

1. The compensation arrangement must be approved in advance of paying compensation by an authorized body of the applicable tax-exempt organization, which is composed of individuals who do not have a conflict of interest concerning the transaction,[5]
2. Prior to making its determination, the authorized body obtained and relied upon appropriate data as to comparability, and
3. The authorized body adequately and timely documented the basis for its determination concurrently with making that determination.

**Authorized Independent Body Free of Conflicts**: The authorizing body that approves the transaction may be comprised of the full board or a smaller authorized board committee, as long as all of the members do not have a conflict of interest. Treasury regulations identify five conditions that must be satisfied to establish the absence of a conflict of interest. The members of the authorized body should not consist of the following:

- The person whose compensation is being determined or anyone related to that person who will participate in, or economically benefit from, the transaction or arrangement;
- A person in an employment relationship subject to the direction or control of the person whose compensation is being determined;
- A person who receives compensation or other payments subject to approval by the person whose compensation is being determined;
- A person who has a material financial interest affected by the transaction or arrangement; or
- Any person who receives or will receive from the person whose compensation is being determined approval of a transaction benefiting such person in turn for such person's approval of the transaction providing economic benefits to the person whose compensation is being determined.

The authorizing body may invite the person whose compensation is being determined (or another conflicted person) to come to a meeting and answer questions with respect to the transaction or arrangement, so long as that person recuses themselves from the meeting and is not present during debate and voting of the transaction or arrangement.

Executive compensation may be reviewed and approved annually by the board of directors (or a compensation committee or task force that makes recommendations to the full board). This may be conducted in conjunction with the annual budget process and/or performance reviews. Alternatively, some organizations choose to complete the review of executives annually and review their compensation every 2-3 years, depending on the nature of their agreement.

see https://www.irs.gov/charities-non-profits/charitable-organizations/rebuttable-presumption-intermediate-sanctions.

[5] The person whose compensation is under review should not be part of the review process or the independent body conducting the compensation review.

**Appropriate Comparability Data**: The authorizing body should ensure that the compensation arrangement is fair and reasonable to the charitable organization, does not provide an excess benefit to any private individuals or companies and is in the best interest of the organization. The best way to do this is to compare it to similar transactions or arrangements by similar institutions.

While regulations do not specify the types of information or number of comparables required for a review, they do indicate that the authorized body must use its judgement, given the knowledge and expertise of the body's members, to determine whether the information gathered is sufficient to satisfy the standard set in the regulations (i.e., that "the compensation arrangement in its entirety is reasonable"). The particular facts and circumstances of the situation must be used to determine whether sufficient and appropriate data is obtained and reviewed by the authorizing body for its decision.

Note: As a general rule for charities with annual gross receipts of less than $1 million (based on an average of its gross receipts during the three prior taxable years – including receipts from any controlled entities), there is a special rule that provides that three comparables of similarly-situated organizations and positions will be considered appropriate.

Comparability data must be gathered and presented to the authorizing body in advance of or at the meeting. Ideally, the data should be presented in writing and provided in advance, to allow for sufficient time to review and analyze.

The organization's conflict of interest policy and procedures can be another key element of the compensation process, especially in cases where disqualified persons are involved or other individuals may have an interest in the outcome of the decision. (For more information about how foundations can manage conflicts of interest, see "What Boards and Executives Need to Know About Conflicts of Interest.")

Additionally, the organization must approve compensation arrangements in advance of paying the individual's compensation and document the process in writing. The IRS Form 990 instructions (pg. 23-24, specifically regarding Line 15) provide additional information regarding compensation procedures.

Documentation for this process by the board must include:

(1) The terms of the transaction and date of its approval.
(2) The members of the board present for the discussion and vote.
(3) The data used for the determination.
(4) Any board members with conflicts of interest and the actions taken.
(5) Documentation for the final decision of the board. (Minutes of the meeting of the compensation committee or task force conducting the review may be sufficient, depending on the level of detail included within the document.)

Organizations should not implement a compensation strategy that calculates compensation based on a percentage of the organization's assets or income/revenue. This prohibition applies to staff and trustees of foundations, as well as other staff of charitable organizations. Some foundations may be exploring implementation of percentage-based compensation for internal or external fundraisers in particular. Foundations should consult qualified legal counsel before doing so, and ensure such compensation will be "reasonable." It should also be noted that in many states, such as Michigan, basing an employee or contractor's compensation on the amount of funds raised makes them a "professional fundraiser" with attendant registration and disclosure requirements.

**Adequate and Timely Documentation**: The documentation of the authorized body should include the terms of the transaction and the date of its approval, the members of the authorized body present during the debate and vote on the transaction, the comparability data obtained and relied upon, the actions of any members of the authorized body having a conflict of interest, and documentation of the basis for the determination.

### Penalties for Excessive Compensation

Section 4958 of the Internal Revenue Code imposes an excise tax on excess benefit transactions between a disqualified person and a private foundation or public charity (in addition to certain other tax exempt organizations). The disqualified person who benefits from an excess benefit transaction is liable for the excise tax. An organization manager may also be liable for an excise tax on the excess benefit transaction.

Payment of more than reasonable compensation is an "excess benefit transaction" that, in addition to liability to the recipient of the compensation, may subject the organization's managers who approved the compensation "knowing" that it was unreasonable, to personal liability. Treasury Reg. 53.4958-1(d)(4)(iii) provides protection for the organization managers against the excise tax even if the compensation is determined to be unreasonable. To get this protection, the managers must obtain an opinion letter from a qualified, independent professional (legal counsel, CPA, or qualified compensation consultant, as referenced earlier in this document). An organization manager's participation in a transaction is ordinarily not considered "knowing" within the meaning of section 4958(a)(2), even though the transaction is subsequently held to be an excess benefit transaction, to the extent that, after full disclosure of the factual situation to an appropriate professional, the organization manager relies on a reasoned written opinion[6] of that professional with respect to elements of the transaction within the professional's expertise. Note that the regulations require that certain disclosures be included in the opinion letter, so guidance should be sought if pursuing this protection.

If the organization involved is a private foundation, it may also incur self-dealing penalties under Internal Revenue Code Section 4941 (as described in more detail below).

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[6] A written opinion is "reasoned" even though it reaches a conclusion that is subsequently determined to be incorrect so long as the opinion addresses itself to the facts and the applicable standards. However, a written opinion is not reasoned if it does nothing more than recite the facts and express a conclusion.

Concerns about excess compensation for foundations continue to be a priority for the IRS. In addition, public perception and reputational risk to the organization endure, oftentimes due to journalists and watch groups investigating organizations via publicly filed IRS Form 990 or 990-PF.

An excise tax equal to 25% of the excess benefit is imposed on each excess benefit transaction between an applicable tax-exempt organization and a disqualified person. The disqualified person who benefited from the transaction is liable for the tax. If the 25% tax is imposed and the excess benefit transaction is not corrected within the taxable period, an additional excise tax equal to 200% of the excess benefit is imposed. In addition, an excise tax equal to 10% of the excess benefit may be imposed on the participation of an organization manager in an excess benefit transaction between an applicable tax-exempt organization and a disqualified person. A person may be liable for both the tax paid by the disqualified person and this organization manager tax in some circumstances.

For self-dealing transactions (involving private foundations), an excise tax of 10% of the amount involved in the act of self-dealing is imposed on the disqualified person. An excise tax of 5% of the amount involved is imposed on a foundation manager who knowingly participates in an act of self-dealing, unless due to reasonable cause (which includes reliance upon a "reasoned opinion" of counsel as described above). These taxes escalate if the self-dealing is not corrected in a timely manner. If more than one person is liable for the initial and additional taxes, all parties will be jointly and severally liable[7] for those taxes. A foundation may not indemnify a self-dealer, and most director and officer liability policies exclude coverage for these wrongdoing activities. However, if such a policy does cover them, then the *pro rata* portion of the premium of such policy may need to be claimed as income by the applicable directors and officers, and the foundation should issue them 1099s. Self-dealing must also be disclosed on the foundation's IRS Form 990-PFs, which is a publicly available document.

## The Compensation Package

Compensation may take numerous forms. In addition to a base salary, benefits and other costs should also be considered within an executive or staff member's overall compensation package.

The total annual compensation calculation recorded on the IRS Form 990 includes both salary and benefits. Organizations should be cognizant of the fact that total compensation for top-level staff/executives, as well as board members, is publicly accessible via the IRS Form 990 or 990-PF.

Note that compensation should be considered reasonable and proportionate to the services and role of the individual and aligned with any available industry standards for acceptable compensation.

Organizations may choose to aim for a particular percentile range within comparable salary data (see the section below on "Compensation Data"). For example, some organizations and sources use the 50th

[7] This legal terminology refers to the fact that any one person that is liable could be liable for the full amount of the fines and penalties. "Jointly and severally liable" means that the person claiming an amount is owed can pursue all of the people or any one of the people involved and collect from them the amount that is due from the whole group.

percentile or below as a "safe" number for setting compensation.[8] Above the 50th percentile (and certainly beyond the 75th percentile) is considered potentially excessive or more likely to be scrutinized by the IRS and other external entities. In some cases, higher levels of compensation may be justified to recruit particularly qualified or exceptional candidates, compete against other offers or in situations where an incoming executive is expected to correct for mistakes or expand into new areas of work. Organizations considering whether larger-than-typical compensation packages should engage with qualified external counsel (see the section above on "External Expertise").

As previously referenced, while a compensation package may be justified based on comparative data, organizations should be aware of public perception of total compensation that may seem excessive, even if it does not meet the criteria of the IRS's definition of "excessive compensation."

### Base Salary

An individual's base salary may be dependent on a variety of factors specific to the position and organization.

**Position Type**: The base salary varies widely by position type. The required responsibilities, experience level and training for a position directly impacts the appropriate salary range.

**Organization-Specific Indicators**: The base salary of an individual's salary also varies based on other factors specific to the grantmaking organization. For example, the organization's overall asset size is oftentimes used as a means of comparing the size of grantmakers to peer institutions. Likewise, the organization's relative geographic location may directly impact the overall salary for a position, whether regionally or in terms of other location factors (i.e., urban, rural) that influence its ability to recruit qualified talent.

**Full-Time vs. Part-Time**: Compensation data is typically provided based on comparable data for full-time positions. However, numerous grantmaking positions are not considered to be full time. Instead, individuals may work part-time either using an hourly rate or part-time salary (a total salary for a pre-designated number of hours per week or month). Organizations should determine an appropriate salary structure that fits the nature of the work.

**Exempt vs. Non-exempt**: Positions are oftentimes divided into exempt and non-exempt categories. Exempt positions are typically categorized as "executive," "professional" and "administrative." These positions are "exempt" from Fair Labor Standards Act (FLSA)[9] overtime rules, meaning that they do not receive pay for overtime. These individuals are oftentimes compensated based on a weekly, biweekly or annual salary. In comparison, "non-exempt" positions typically perform their duties based on an hourly rate (or a limited number of hours for

[8] Note that compensation includes both salary and other financial benefits. In considering percentile-based data in many of the industry compensation reports, most of that data exclusively focuses on salary data. Organizations must consider the relative percentile applicable to total compensation, which is the aspect of the IRS Form 990 or 990-PF examined by the IRS.
[9] For more information, see https://www.dol.gov/agencies/whd/fact-sheets/17a-overtime.

a given salary) and are entitled to overtime pay. The determination of which positions are exempt or non-exempt is based on a three-factor test described in the FLSA. Organizations may need to consult with qualified legal counsel to ensure that positions are accurately classified.

### Benefits

An individual's benefits package may be calculated as a specific percentage of their salary or consistent with other staff of the same level within the hierarchy of the organization. Some executives may have additional benefits offered, due to their seniority or additional responsibilities.

**Healthcare**: Foundations may offer a range of health/medical benefits to employees. Employers may choose from a variety of plan types, including Health Maintenance Organizations (HMO), Preferred Provider Organization (PPO), Point of Service (POS), High Deductible Health (HDH) or Healthcare Flexible Spending Account options. Likewise, employers can choose what portion of premium costs to cover for employees. Additional levels of coverage may also be offered for Vision, Dental and Short- and Long-term Disability.

**Retirement**: Foundations may offer a range of retirement/contribution plans, such as a 401(b) plan, 401(k), Simplified Employee Pension (SEP IRA) or Simple IRA, among others. Employers may contribute a percentage of an employee's base salary to the plan.

**Paid Leave**: Paid leave may take a variety of forms, including vacation, sick leave, paid holidays, maternity/paternity leave, adoption leave, bereavement leave, jury duty and other pre-designated forms of paid time off.

**Other**: Organizations vary widely in the types of benefits that they offer to employees. In some cases, these are benefits available to all employees, such as covering fees for parking in a pre-designated structure, professional development and tuition assistance. Some benefits may only be available to a CEO or other high-level executive positions, such as memberships for professional associations, access to a business cell phone or company vehicle, or other benefits that directly impact the CEO's ability to conduct business.

**Deferred Compensation**: Foundations may vary in the types of deferred compensation offered, especially for executives and key staff. An employee would typically receive deferred compensation upon reaching retirement age, at which point taxes would be due. All employees may be eligible for retirement plans (i.e., 401(k) or 403(b) plans), whereas other types of deferred compensation (i.e., deferred savings plans and supplemental executive retirement plans) may be offered to executives.

### Other Costs

Employing staff within a foundation requires budgeting for a base salary, benefits and other additional costs that must be covered by the organization. Some of these costs are optional, while others are required by local, state, or federal governments.

**Workers' Compensation**: Most organizations in the state of Michigan must obtain workers' compensation insurance, with limited exceptions.

**Taxes and Required Filings**: Foundations with paid staff are required to file FICA (Social Security and Medicare); federal, state, and local income tax withholding (including unemployment insurance following state requirements); and reporting of fringe benefits.

## Raises and Bonuses

Both raises and bonuses can serve as a key element of an organization's employee retention strategy. Raises involve a permanent increase in an employee's compensation, oftentimes based on a percentage of their salary and/or benefits. In comparison, bonuses can vary widely and may be a periodic option for employees to reward employees for achieving key performance metrics.

### Types of Raises

**Cost of Living Adjustment**: A cost of living adjustment (COLA) is typically a relatively small percentage increase in an employee's salary intended to increase at approximately the rate of inflation. This may also be called a "CPI" (for Consumers Price Index) or "inflation-adjusted" raise.

**Performance/Merit**: A merit increase or performance increase may be added to an employee's salary or compensation as a percentage or lump sum. This increase is generally connected to the results of a performance review.

**General**: Some organizations choose to provide a raise to all staff members that is not connected to a cost of living adjustment or individual job performance.

**Special/One-Time**: Other types of raises may be tied to special situations, such as when an employee receives a promotion. Other increases may be made due to adjustments made to an organization, department or salary band of employees to adjust to comparable compensation in the industry.

### Bonus Structures

Bonuses to executives or staff may be made based on numerous key indicators, including employee performance (the achievement of select goals), tenure or the financial condition of the organization (oftentimes based on the growth of the endowment). Bonuses may be based on a percentage of an individual's salary or a flat dollar amount. The presence of bonuses within a total compensation package varies widely by organizational type and size.

## Equity and Transparency Issues

Organizations are becoming increasingly aware of equity and transparency issues as pertaining to hiring and compensation processes.

A key aspect of an equitable process involves ensuring transparency for those involved. For example, tying raises or bonuses to a performance review or discussion requires that individuals are aware of expectations and the process involved in obtaining a raise. Similarly, transparency is needed regarding the overall process involved in determining compensation, with employees informed in advance and with opportunity to ask questions about their compensation.

Many organizations publicly share the salary range of a position within job postings. Offering this information to potential job applicants allows individuals to request appropriate compensation for the position and avoids wasting their time if applying for a position that would ultimately be a mismatch for their salary needs (and similarly avoids wasting the time of organization staff in interviewing them).

Another critical element of equitable pay is ensuring that any structured salary ranges for each position are fair within departments and across the institution. A compensation consultant can be helpful in reviewing salary ranges relative to industry standards, geography and other factors. See "Compensation Data" for other such resources available to foundations.

Employee confidentiality is key to ensuring that equity and transparency concerns are handled appropriately. While the general process for determining compensation may be shared or the salary range for a position is made public, employees should feel confident that their individual data and compensation information is secure. Likewise, they should be comfortable knowing that all discussions regarding compensation are held in confidence and relevant information is only shared with appropriate staff members responsible for such decision making.

## Special Issues for Private Foundations

Excessive and unreasonable compensation are of particular concern in situations involving founders, family members and other "insiders," known as disqualified persons. Foundations are permitted to provide compensation to disqualified persons for personal services considered to be "reasonable and necessary" to carrying out the charitable purposes of the organization. Personal services must be "professional and managerial" in nature. The IRS has ruled that legal, accounting and investment advising qualify for the exception, as do certain other services, but janitorial services do not. Rulings on secretarial services have gone both ways. Foundations should seek advice from knowledgeable counsel before engaging with disqualified persons for services.

The IRS defines reasonable compensation as the value that would ordinarily be paid for like services by like enterprises under like circumstances, based upon all the facts and circumstances.

For more information on self-dealing and compensation to disqualified persons, see CMF's resource, "What Boards and Executives Need to Know About Self-Dealing."

## Compensation Data

Foundations have numerous options for identifying appropriate sources of compensation data.[10] Many reports are focused on particular categories of organizations or geographic regions, or represent the membership of specific professional associations. Individuals utilizing these reports can typically navigate these publications based on data tables organized by position type, organizational size (staff size or asset size), geographic location or organizational type.

A variety of compensation reports are widely available for grantmaking organizations, including both private foundations and public charities. Many of these reports include salary data, as well as comparative information regarding benefits, raises, and other common topics of interest when considering compensation for staff. Examples of such reports[11] include:

- The **Council of Michigan Foundations**, in partnership with other philanthropy-serving organizations throughout the region, produce the "**Midwest Grantmaker Salary, Benefits, and Demographics Report**." This report is available at https://www.michiganfoundations.org/resources/2022-midwest-grantmaker-salary-benefits-demographics-report and is free for CMF members with a member log-in. Members of the Council of Michigan Foundations can also contact Ask CMF (www.michiganfoundations.org/practice/ask-cmf) to request a free customized salary report.
- The **Council on Foundations' "Grantmaker Salary and Benefits Report"** is considered one of the most comprehensive salary survey reports available for foundations in the U.S. The full survey report (https://cof.org/grantmaker-salary-benefits) releases in late fall; it includes both salary and benefits data.
- The **Michigan Nonprofit Association** releases its **"Compensation and Benefit Report,"** available at https://www.mnaonline.org/services/tools/compensation-benefits-report. This report includes salary and benefits data for nonprofits, with a fair number of Michigan-based foundations included in the report.
- **Exponent Philanthropy** also produces an annual **"Foundation Operations and Management Report,"** which is particularly designed for more leanly staffed foundations (0-8 staff members). This report may be particularly useful to family foundations and those foundations that are relatively limited in staff, independent of their asset size. The report is available at http://www.exponentphilanthropy.org/publication/foundation-operations-and-management-report/.

Foundations that participate in these salary surveys may have free access to these reports, as well as potential benchmarking within those datasets. Participating in salary surveys also provides essential

[10] While organizations may look to for-profit data in some instances, ideally the compensation committee should gather the vast majority of its data from data sets focused on charitable entities.

[11] The purchase price of these reports may vary based on an organization's membership status with the authoring institutions. Please note that membership in the Council of Michigan Foundations does not equate with membership in the Council on Foundations, Michigan Nonprofit Association or Exponent Philanthropy. However, organizations may have a membership to these or other institutions that offer available salary survey data.

comparable data to the field at large, which is critical to ensuring that all organizations have access to compensation numbers from a range of organizational types and sizes.

Many grantmakers also conduct compensation research on peer organizations, based on similar size, structure or geographic location. Staff may contact other organizations directly to request comparable compensation data or look to the publicly available IRS Form 990/990-PF, particularly for high-ranking staff positions or those found in small organizations.

Foundations should also be aware of additional sources of data that may be available to them, based on their size, structure, location or memberships with other professional associations.

For reference, some of the key terms that may be useful in interpreting common compensation data reports are as follows:

- Average/Mean: The average or mean value is found near the middle of a data set, calculated by dividing the sum of the data set by the number of values with in it. For example, a data set of 2, 3, 6, 7, and 8 would be calculated as: (2+3+6+7+8)/5=5.2. An average/mean does not have to be an actual, whole number within the data set.
- Median: The median is the central or midpoint value within a data set. For example, a data set of 2, 3, 6, 7, and 8 would have 6 as the median value. For data sets with an even number of values, the middle two values are averaged to reach a median value. The median may also be known as the 50th percentile.
- 25th percentile: Known as the first quartile, the 25th percentile means that 25% of the values are lower than this point in the data set. For salary survey data, the 25th percentile would indicate the salary is closer to the lower end of the salary scale for a given category.
- 75th percentile: Also known as the third quartile, the 75th percentile means that 75% of the values are lower than this point in the data set. For salary survey data, the 75th percentile would indicate the salary is closer to the higher end of the salary scale for a given category.

## Board Compensation

The issue of board compensation has been debated throughout the field, especially among private foundations.

Board compensation can take numerous forms. Some foundations choose to reimburse board members for allowable expenses, while others utilize stipends to cover board members' time for attending board meetings and conducting business on behalf of the organization.

Organizations contemplating the issue of compensation for board members should create a clear policy that outlines forms of compensation that are and are not permitted. Any form of compensation must be considered "reasonable," based on external data for comparable activities conducted by comparable organizations.

The types and amounts of compensation vary extensively from one organization to another. For example, the National Center for Family Philanthropy's "Trends 2020" report (pg. 66) indicated that 35% of family foundations provided stipends to board members, 30% provided reimbursements for out-of-pocket expenses and 35% of organizations did not provide any form of reimbursement for board expenses. Within that report, only 12% of family foundation respondents paid more than $5,000 annually in compensation to board members. Exponent Philanthropy's annual "Foundation Operations and Management Report" and the Council on Foundation's "2022 Grantmaker Salary and Benefits Report" also include relevant data on board compensation.

In some states, organizations are required to engage an independent compensation consultant to provide a certified opinion regarding board compensation due to the conflict of interest involved. At the time of publication, this is not currently a requirement in the state of Michigan. In situations where significant (as opposed to modest) compensation is being considered, organizations should consider seeking a compensation opinion.

Foundations should have appropriate policies in place to address the issue of board members' travel and reimbursement expenses. Organizations are permitted to reimburse or pay for the expenses of employees and trustees if such expenses are considered necessary to carrying out the foundation's exempt purposes, and the amount must be considered reasonable. Generally, reimbursement of expenses is restricted to individuals serving the foundation in an official capacity (not their spouses or other family members). Private foundations should be cognizant of self-dealing concerns regarding permissible expenses for board members and other disqualified persons. For more information, see CMF's resource, "What Boards and Executives Need to Know About Self-Dealing."

Additional information regarding situations in which a board member may be compensated for conducting a service to the foundation is addressed in the CMF resource, "What Board and Executives Need to Know About Conflicts of Interest."

## To Learn More


BoardSource. "Executive Evaluation and Compensation." https://boardsource.org/fundamental-topics-of-nonprofit-board-service/executive-evaluation-compensation/.

Council of Michigan Foundations. "An Operations Checklist for Foundation Compliance." 2022. https://www.michiganfoundations.org/resources/operations-checklist-foundation-compliance.

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This document was authored by Brittany Kienker, Ph.D., Knowledge Insights Expert in Residence for the Council of Michigan Foundations (CMF). Legal aspects of this document were reviewed by Jennifer Oertel, outside legal counsel to CMF. CMF members can find answers to their most pressing questions through CMF’s Knowledge Insights division, including Ask CMF, the Knowledge Center and the Sample Documents Hub. Ask CMF is a free service to CMF members, available through the “Ask CMF” link on the CMF homepage or by visiting https://www.michiganfoundations.org/practice/ask-cmf.