Best Practices in Nonprofit Compensation:

“What You Don’t Know You Don’t Know Can Cost You”

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The Standards for Excellence: An Ethics and Accountability Code for the Nonprofit Sector states, ***“The full board, or a designated committee of the board, should hire the executive, set the executive’s compensation, and annually evaluate the executive’s performance. In cases where a designated committee performs this responsibility, the details of the process should be reported to the full board….The board should periodically review the appropriateness of the overall compensation structure of the organization.”***[1]

How does your nonprofit organization implement the best practices related to compensation? The answers lie in your responses to the following questions:

1.) When the last CEO/ Executive Director was hired did the board review comparable salaries and benefit packages for comparable positions to ensure that the compensation package is comparable to others in your local area/ region?

2.) When was the last time the board reviewed local/regional salary comparisons for the CEO/Executive Director position?

3.) When was the last time management conducted a salary/wage comparison for other positions in the organization and shared results with the board?

What the standards language doesn’t specifically state is that, according to best practices, the board should annually set the compensation for the CEO and periodically (i.e., at least every three to five years) review the CEO’s and full staff’s compensation structure. As part of this effort, the board should ensure that the salary rates for other employees (both management and rank and file) are reviewed for comparability with similar industries and local/regional salaries and wages. The board should also “set policy” related to where the organization wishes to “fall” in comparison to the salaries/wages of comparable positions in other organizations. Such a compensation policy will help the organization determine if the salaries for the organization’s employees should be in the 25th percentile (among the bottom 25% of salaries in the local/regional area for comparable positions) or

should the salaries be in the 75th percentile (only 25% of the regions employees in comparable positions are paid higher)?

There are several reasons why it is important for nonprofit agencies to adhere to these best practices. According to Guidestar, "The Pension Protection Act of 2006 increased the penalties for excessive benefit transactions, including overpayment of non-profit executives. Meanwhile, Congress, donors, and the media continue to scrutinize nonprofit salaries. Nonprofits must demonstrate to oversight agencies, grant makers of all types (government, corporations, and private foundations), and individual donors that the salaries and benefits they offer are justified. They must document their compensation practices and be prepared to help their supporters understand why these practices are appropriate."[2] This is especially important when nonprofits run the risk that their employees are ***overpaid.***

On the other hand, many nonprofit executives and employees are ***underpaid***. Some, especially in small to medium sized nonprofits, faith based organizations and church ministries are woefully underpaid. Boards justify this inequitable situation by claiming that the organization is a nonprofit and thereby justified in paying its employees less. However, there are two other costs many boards fail to recognize related to its compensation policies that should be considered: the cost of turnover and the cost related to the lack of technical competency.

According to a report published in 2012 by the Center for American Progress, "***Implementing workplace policies that benefit workers and help boost employee retention is not simply a "nice" thing for businesses to do for their employees. Maintaining a stable workforce by reducing employee turnover through better benefits and flexible workplace policies also makes good business sense, as it can result in significant cost savings to employers."***[3] This study estimates that the cost of turnover can be up to 20% of the annual salary and states that other studies estimate that the cost of turnover in health care organizations can be up to 5% of the total operating expense. Many boards fail to recognize the cost associated with turnover because they say it is a "soft cost" (not able to be easily calculated). If you'd like to assess the actual costs related to employee turnover for your organization, you may find completing an employee turnover worksheet helpful. This type of exercise is eye-opening for many nonprofit leaders. The cost of turnover can be mitigated by implementing workplace flexibility and earned sick days at little to no cost at all or by implementing incremental pay raises to ensure comparability with similar positions.

The other cost that is often not recognized is the "opportunity" cost that is incurred when a nonprofit hires someone who is less technically qualified than the organization/position needs because "we can't afford it." While not typically quantified, this often leads to less than optimal performance, hiring consultants or others later to fill in the skill gap and/or turnover because the individual simply can't perform the job that is required. I have seen this happen numerous times where small nonprofits fail and some ultimately dissolve because of this.

So what should a responsible nonprofit organization do related to compensation to ensure sustainability? Best practices suggest that every nonprofit board should ensure that their organization should:

1.) Conduct a salary comparison for every position in the organization every three to 5 years. **Guidestar publishes an annual report to assist with this effort. Their 2013 report is derived**

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from information on more than 135,000 individual positions at more than 94,000 tax-exempt organizations. The executive summary presents findings based not only on the current report but also on data for previous years. There are numerous other salary studies conducted in local areas and state and national databases where comparable salary information can be found.

2.) Determine an equitable organization-wide compensation policy and implement it.

This means discussing and determining how comparable your organization's salaries are and where you feel they should be relative to others in your local area region. Should the wages for the agency be in the 25th percentile or the 50th percentile or something else? The CEO's compensation should not be in the 90th percentile, while the rank and file employee's is in the 10th percentile.

3.) Challenge the "we can't afford it" assumption.

If your organization does not currently have a policy where your salaries are somewhere near the 50th percentile of comparable salaries in the region, your organization may not be aware of the costs associated with turnover and/or lack of technical skills. If you need to adjust compensation because your organization is underpaying staff, you may need to readjust your total budget, your overall cost structure and your fundraising efforts as well.

Most organizations, depending on their size, will achieve a return on investment by making changes that can be absorbed within their current budgets, even if they require a short term cash investment. For others, challenging the "we can't afford it" assumption leads to the question of whether the organization is sustainable over the long run. Part of the fiduciary responsibility of a nonprofit board is to ensure that the organization has the resources to sustain its mission. If the organization truly cannot afford to equitably pay staff with the current level of resources or make a case for support for additional investment based on outcomes, then the board should be questioning the operating model of the organization and looking for ways to collaborate to share costs and increase operating efficiencies in other ways.

1. Standards for Excellence Institute, 1998-2012, Standards for Excellence: An Ethics and Accountability Code for the Nonprofit Sector, www.standardsforexcellenceinstitute.org.
2. 2013 Guidestar Nonprofit Compensation Report.
3. Boushey, Heather and Glynn, Sarah Jane. "There are Significant Business Costs to Replacing Employees." Center for American Progress, November, 2012.

ning, research and organizational development firm, with offices in Erie and Leadership program at Duquesne University and a Standards for

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