Executive Compensation

What should a nonprofit pay its chief executive?

The board of directors is responsible for hiring and establishing compensation (salary and benefits) for the executive director/CEO that is “reasonable and not excessive,” but is also enough to attract and retain the best possible talent to lead the organization.

The recommended process for determining the appropriate compensation is to adopt a written policy that the board will conduct a review of the executive’s compensation that includes a comparison of compensation paid by similarly-sized peer organizations in the same geographic location. Conducting (and documenting) this comparison creates a “rebuttable presumption” that the compensation provided by the nonprofit to its executive director is “reasonable and not excessive.”

Nonprofits filing IRS Form 990 must describe the process they use to approve executive compensation as part of the nonprofit’s responses on the annual return, IRS Form 990, Part VI, Section B, line 15.

Boards that engage in an annual process of reviewing and approving the compensation of the executive director/CEO, and that document this process in the board meeting minutes, will be protecting their nonprofit (and themselves).
Practice Pointers:

(1) Repeat the process every year: When drafting the annual calendar for the nonprofit’s activities, choose the same time every year for the board of directors (or a compensation task force of the board) to review and approve the executive director’s compensation. Many nonprofits conduct the review in advance of or in conjunction with the annual budget process.

(2) Where can you find comparability data? Your state association of nonprofits may conduct salary surveys and offer state-specific compensation reports. Other sources include outside compensation consultants and Candid, which collects executive salary data from IRS 990 filings and makes the data available for a fee.

What is "reasonable" compensation according to the IRS?

The IRS recommends that charitable nonprofits follow its three-step process to determine that compensation is reasonable and not excessive. (See also Treas. Reg. § 53.4958-6(a))

1. The board should arrange for an "independent body" (meaning that the person receiving the compensation should not be part of the review process) to conduct a "comparability review." Many nonprofits task a "compensation committee," or use their executive committee or another sub-group/task force of board members, for this purpose.

2. The independent body should take a look at "comparable" salary and benefits data, such as that available from salary and benefit surveys, to learn what nonprofit employers with similar missions, and of a similar budget size, that are located in the same or a similar geographic region, pay their senior leaders. Example: it would not be comparable to compare the compensation of a CEO of a large urban hospital or university to that of a rural day care center’s CEO.

3. The independent body that is conducting the review should document who was involved and the process used to conduct the review, as well as document the full board’s decision to approve the executive director's compensation (minutes of a meeting are fine for this). The documentation should demonstrate that the board considered the comparable data when it approved
the compensation. See instructions to the IRS Form 990 (see pages 23-24, specifically the explanation for Line 15). Nonprofits filing the Form 990 must describe the process on Schedule O.

- FAQs about setting executive compensation (IRS)

Practice Pointers

- Having a robust conflict of interest policy is another important aspect of ensuring fair and reasonable compensation.
- Compensation includes salary and benefits, such as insurance, a car, housing allowance, or other fringe benefits, that should be included in the calculation of total annual compensation. See instructions to IRS Form 990, pages 31-32.
- The instructions to Form 990 also include a glossary of terms and a table that shows precisely how and where to report the many types of "other compensation" that should be included in total compensation.

Tools for Boards

- To ensure executives of color have not only pay equity but also the specific supports and resources they may need, consult reports from the Race to Lead program, especially its 2019 report on nonprofit executives of color, Trading Glass Ceilings for Glass Cliffs.
- Review a sample policy for board approval of compensation prepared as an illustration for small nonprofits by the National Council of Nonprofits.
- Setting nonprofit executive compensation and the role of the compensation committee (Charity Lawyer Blog)
- Sample CEO self-evaluation tool (National Council of Nonprofits)

Additional Resources

- Executive evaluation and compensation (BoardSource)
- What You Need to Know about Nonprofit Executive Compensation (Candid)
- More guidance on “rebuttable presumption of reasonableness procedures” (Nonprofit Law Blog)
- IRS Form 990, and instructions to Form 990
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