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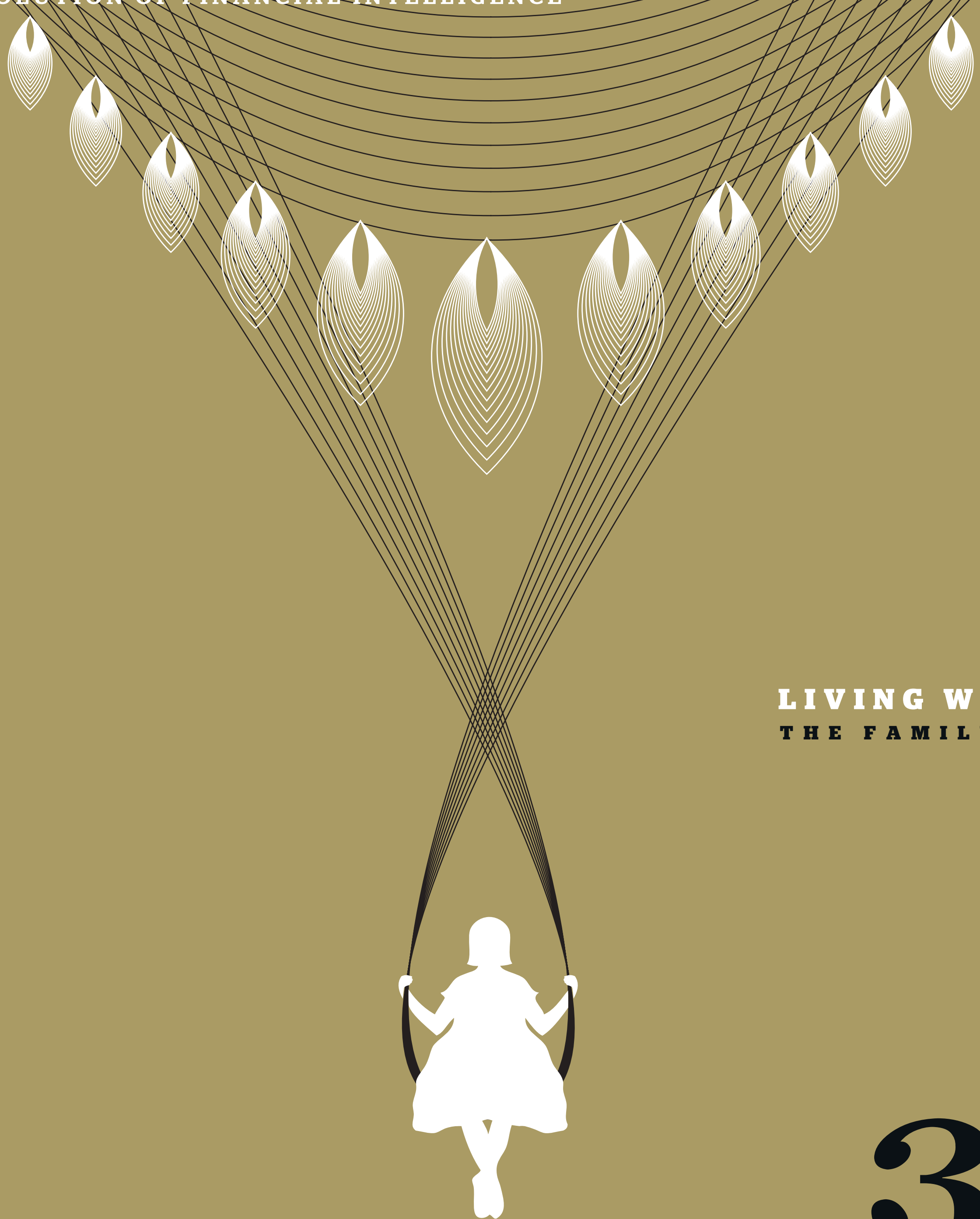

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Sterling Investment Advisors Ltd.

Timothy E. Flatley, ChFC®, President

"How can nonprofit institutions compete with for-profits on executive salaries?"

By Timothy E. Flatley

Nonprofit institutions provide many great services to communities, and like any other business they have to recruit quality senior personnel. However, they are often at a salary disadvantage when competing with for-profit businesses. Recently, we were speaking with Charlie Scott, a senior compensation consulting professional and the owner of CTS Consulting Group. Charlie provided the following thoughts on this subject:

"The growth in NFP (not-for-profit) executive salaries is a continual cause of concern among boards. Constituents, especially those who provide the sources of funding for the NFP, look at rising executive salaries and cannot help but worry that their grants/contributions may not be used as intended. Some boards are addressing the pressure to raise pay by creating cash incentive plans which, at the very least, make it clear that compensation is tied to mission and business-related goals. But another area remains less explored, that is, the ability to trade increases in current salary for enhanced retirement-income adequacy.

"Generally speaking, with the exception of a few sectors of NFPs (most notably higher education and health care), executive retirement plans do not fund a reasonable replacement percentage of pre-retirement compensation. Boards that wonder whether their approach to executive compensation is too heavily weighted toward current cash compensation may wish to re-think their overall philosophy—and soon! Too often, board consideration of executive retirement is left to the last few years of an executive's working career, when, by that point, the cost to fund an adequate retirement can be prohibitive."

Unlike their for-profit brethren, nonprofits do not provide incentive benefits like stock options or restricted stock. However, there are a number of plans specifically designed for nonprofits that can properly reward a career for the executives that lead them.

Our recent consultation to a nonprofit illustrates an example of how these plans work: The executive director had worked over 20 years for the nonprofit. Over the years the board of directors evolved. At different times and on a somewhat ad hoc basis, the directors implemented a variety of retirement plans.

Beyond the executive's base salary, the organization offered a 403(b) and 457(b) plan. A 403(b) is essentially the nonprofit version of the 401(k) plan. The 457(b) plan offers the opportunity to the employee, the employer or both to contribute up to an additional $17,500 (2014 limit) on a pretax basis.

We first conducted a study of executives in similar organizations and determined what plans were being offered. We also learned how much income would be replaced at retirement from the peer organizations and how much would be replaced by the director's organization. We discovered that the peer group would receive 50 percent of their income at retirement, while our client's plans would replace only 44 percent of his pay. We worked with the board to determine what metrics would be used for performance evaluation, and, if they were achieved, how the retirement funding for the executive would increase to replace 50 percent of his working income.

A cash bonus could be used for the excess funding, but the executive did not require the funds immediately and would pay even higher taxes with an increased bonus. We recommended the implementation of a 457(f) plan. The organization may make discretionary incentive contributions to a 457(f) plan, in addition to the 457(b) limits, to recruit, retain and reward selected key employees.

In order to attract and retain top-notch executives, nonprofit organizations must periodically evaluate their compensation methods, not only to ensure they remain competitive with for-profit companies, but also to verify that they are optimizing the various nontraditional-retirement plan options available to them.

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