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Designing an Effective Compensation Committee Process

The annual process of setting the compensation for an organization's President, CEO or Executive Director or other key executives has been the subject of much discussion and scrutiny for some time. However, many organizations do not have a well thought out and consistent procedure to ensure that the process conforms to good business practice.

Changes to the Internal Revenue Code several years ago established guidelines for organizations that, if followed, provide some comfort that the organization has reached reasonable and prudent conclusions surrounding executive compensation. Absent such a reasonable and documented process, an organization risks having paid an "excess benefit" to the executive and, in addition to a mandatory refund of the amount, the organization may be subject to penalties of up to 100%. Further, the new Form 990 requires a discussion of the compensation committee process.

While the details of the process will vary for each organization, the following are some of the suggested elements of a good Compensation Committee process.

Organizational Meeting

- Develop calendar for action and confirm independence of Committee members
- Review prior year process and report and consider amendments for process improvement
- Identify covered executive personnel
- Identify independent data sources

Data Gathering

- Retrieve covered personnel compensation history (include all elements of compensation)
- Gather independent, outside compensation data (e.g. consultant, survey, Guidestar)
- Gather other sector and economic data (e.g. CPI, local geographic economics)
- Obtain personnel evaluation results, if applicable

Recommendation Development

- Propose preliminary compensation adjustment
- Compare proposed compensation adjustment to comparable independent data
- Conclude compensation recommendation

Conclusion and Documentation

- Prepare report to Board
- Review Committee process and possible improvements for following year
- Prepare minutes of Committee process

Communication

- Present report to Board
- Document communication of actions with covered employee(s)

Regardless of the detailed steps taken by an organization's Compensation Committee it is essential that the members of the Committee are all independent of the executive(s) whose compensation is being determined. It is also critical that the Committee gather contemporaneous, outside independent data covering comparable positions at comparable institutions. And lastly, that the Committee document its process including its ultimate reporting to the governing board.

For more information about how to tailor a Compensation Committee process to the particular needs of your organization contact Garrett Higgins at 914-421-5600 or ghiggins@odmd.com or your ODMD Not for Profit Team professional.

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