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Second Annual Nonprofit Executive Summit:

Bringing Nonprofit Leaders Together to Discuss Legal, Finance, Tax, and Operational Issues Impacting the Sector

Thursday, October 2, 2014
Venable LLP
Washington, DC

Nonprofit Executive Summit Agenda

Panel 1. **Fraud and Embezzlement: The Executive Team's Role in Detecting, Reporting, and Preventing Fraud**

Panel 2. **Executive Employment Contracts: Getting Compliant and Creative**

Keynote. **Midterm Landscape 2014**

Panel 3. **Nonprofit Tax Issues: Where the IRS Is Today, and Where Congress Is Headed**

Panel 4. **Best Practices for Enhancing the Nonprofit Governance Model**

Panel 2

Executive Employment Contracts: Getting Compliant and Creative

Moderator

Kelly Davis, ERPA
Manager
Employee Benefit Plans
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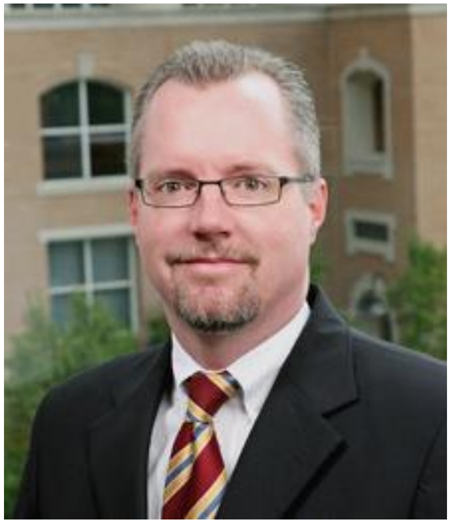

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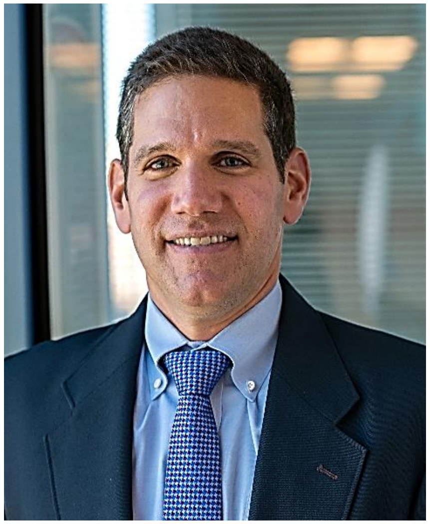

Lawrence D. Sloan, CAE
President and CEO
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Offer Letter vs. Formal Contract

Offer Letter vs. Formal Contract

- Formal contracts provide security to both the executive and the organization.
- Trend: Formal contracts are becoming increasingly common for CEOs. Typical length is 3 to 5 years for both the initial term and contract extension.
- Tip: Be careful with “evergreen” provisions.

Key Compensation Elements

Key Compensation Elements

- Whether in an offer letter or formal agreement, the following compensation elements should be addressed in detail:
  - Base salary
  - Incentive compensation/bonus
  - Deferred compensation
  - Perks

Base Salary

- Not just salary for the initial year but also how salary adjustments will be addressed in future years
  - Automatic increases (cost of living, etc.)
  - Market based (public surveys, compensation consultant, etc.)
- Trend: Common for boards to state that salary will be reviewed annually and adjusted based on performance (organizational and individual) and market movement
- Tip: Review compensation information and salary for prior incumbent (Form 990s) over several years to get a sense of salary levels and annual adjustments.

Bonus

- Your agreement should detail both the “target” and “maximum” bonus opportunity.
  - Critical for setting expectations
  - With board turnover, it is also important for the understanding to be memorialized/documented for consistency.

- Trend: With CEO compensation levels rising, association boards want to tie compensation directly to performance.

- Tip: Make sure there is an established performance evaluation process, and that you are involved in setting goals and metrics.

Deferred Compensation

- Ensuring you have adequate savings to offset retirement costs is critical.
  - Start now rather than waiting until you have a short employment horizon (difficult to accrue ample savings in the last few years)
  - Try to keep the arrangement simple.

- Trend: 457(b) and 457(f) arrangements (detailed on the following slides) are the most common vehicles.

- Tip: Focus the board on the annual dollar amount you desire in deferred comp rather than getting them to commit to a specific income replacement ratio.

“Nonqualified” Deferred Compensation

- Section 457(b) Plan or Agreement
  - Employee contributions limited to $17,500 per year (indexed for inflation)
  - Can be fully vested
  - Minimum distribution rules apply beginning at age 70 ½
  - Taxed only when actually distributed
  - No rollover to IRA or qualified plan
  - Can be transferred to §457(b) plan of subsequent, tax-exempt employer

“Nonqualified” Deferred Compensation

- Section 457(f) Plan or Agreement
  - Contributions—no limit
  - Contributions and earnings must be subject to “substantial risk of forfeiture” for at least two years from date of agreement
  - “Substantial risk of forfeiture” usually means a requirement to perform substantial services until the “substantial risk” lapses (*i.e.*, the vesting date)
  - Vesting date is usually end of contract or anticipated retirement date
  - “Substantial risk” rule not violated if employment terminates before vesting date other than by voluntary resignation (*e.g.*, death, disability, termination by employer)
  - Taxed when vested
  - Can’t extend vesting date
  - Usually distributed when taxed
  - No rollover or transfer to further defer tax
  - May be subject to §409a, if distribution deferred beyond vesting

Excess Benefit Transactions

- Transaction in which an economic benefit is provided, directly or indirectly, by a 501(c)(3) or 501(c)(4) tax-exempt organization, to or for the use of a disqualified person, where the value of the benefit provided exceeds the value of the consideration received by the organization
- Disqualified person is one in a position to exercise substantial influence over the organization’s affairs (includes directors, officers, and key employees)
- Compensation arrangements to disqualified persons must be presumed reasonable and not providing excess benefits

Excess Benefit Transactions

- Reasonableness of compensation for purposes of determining excess benefits - all compensation provided by a 501(c)(3) or 501(c)(4) organization to a disqualified person in exchange for the performance of services is taken into account:
  - Salary, bonuses, severance, deferred compensation, insurance premium payments, fringe benefits, all non-cash compensation

- Excess benefit transactions may result in:
  - Severe sanctions imposed by IRS
  - Revocation of an organization's tax-exempt status
  - Excise taxes (IRC section 4958)

Excess Benefit Transactions

- Presumption of reasonableness of compensation:
  - Compensation arrangement must be approved in advance by an authorized body of the tax-exempt organization, composed of individuals who do not have a conflict of interest concerning the transaction
  - Prior to making its decision, the authorized body obtained and relied upon appropriate data as to comparability, and
  - The authorized body adequately and timely documented the basis for its determination concurrently with making that determination
- IRS can always refute.
- Recommend organization retain all supporting documentation, including transaction terms, approval date, authorized body members present during debate and approval, the comparability data relied upon, and basis for determination

Perks

- Common perks and benefits for CEOs:
  - Supplemental insurance
  - Memberships in professional organizations
  - Annual physical exams

- Trend: With increased scrutiny, the prevalence of CEO perks have been declining (*e.g.*, housing, car leases, sabbaticals, social clubs).

- Tip: Focus only on perks that are important to you (i.e., long-term care or business class travel) – otherwise it might be better to negotiate a higher salary.

Other Key Contractual Elements

Severance

- Discuss severance provision up front while the relationship is strong; understand relationship with “cause” terminations
- Trend: Typically 6 to 12 months of salary
- Tip: Ensure that the severance length is at least as long as any non-compete period. Clarify whether severance is based on base salary or base plus target/pro-rated bonus.

Restrictive Covenants

- Confidentiality
- Non-solicitation
  - Employees
  - Members, customers
- “Do Not Compete”
- Limits on outside activities

Executive Authority and Reporting

- "Full time and attention"
- Description of responsibilities (*a.k.a. The Job Description*)
- Authority over staff
- Report to board or committee
- Annual reviews

Term and Termination

- Term, renewal
- Rights to terminate, “cause”
  - Right of executive to terminate for “good reason”
- Payments upon termination
  - Accrued obligations
  - Severance
  - Liability release as a pre-condition
- Return of records and association property
- Dispute resolution – arbitration vs. courts

Questions?

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October 21, 2014 – Fundraising 201: An Update on Managing the Legal Risks of Nonprofit Fundraising

November 19, 2014 – Enhancing the Nonprofit Governance Model: Legal Pitfalls and Best Practices

December 11, 2014 – LGBT, Religion, and Diversity in the Nonprofit Workplace

Thank You!

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