Pearl Meyer

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How and Why Not-For-Profit Organizations Should Review Compensation Consultant Independence



Wes Hart

MANAGING DIRECTOR

As “independent” compensation committees at not-for-profit organizations develop and review executive compensation programs, particularly for the CEO and other senior executives, it is crucial that any outside advisors to the committee also be deemed “independent” to avoid conflicts of interest and to ensure that the data provided by the advisor will withstand basic IRS scrutiny.

A fundamental responsibility of every nonprofit compensation committee is to ensure that compensation for the CEO is "reasonable and not excessive.” Committees that engage in an annual process of reviewing and approving the compensation of the CEO and then document this process in the minutes of meeting(s) will be protecting their nonprofit (and themselves) from the risk of noncompliance. Any data used for this process needs to originate from an “independent” third party. An IRS challenge of compensation reasonableness will look to the independence of the compensation consultant and the quality of any study, survey, or other data used to establish executive compensation.

It is a best practice for nonprofit businesses to get a written statement of independence from an outside advisor at regular intervals. This is something that public companies receive from their compensation consultants and legal advisors, typically on an annual basis. Independence is no less important at not-for-profit organizations, so they should similarly seek a periodic statement of independence.

The following areas should be considered and summarized within any review/statement of independence:

- Does the advisor provide services to the company other than compensation consulting services? Do these other services create any real or perceived conflicts?
- Does the advisor maintain a robust conflicts and independence policy?
- Do any business or personal relationships exist between the individual consultant(s) managing the company relationship and any compensation committee members?
- Are there any business or personal relationships between the individual consultant(s) managing the company relationship, or the consulting firm itself, and senior executives of that nonprofit organization?

In addition to maintaining independence pursuant to the basic requirements listed above, we also highlight the following as factors which can support conflict-free advisor status:

- Regular discussions between consultant and committee with only the compensation committee (or select members of the compensation committee) present;
- Prohibitions on providing or receiving any gifts, benefits, or donations to or from the nonprofit organization;
- Strict confidentiality and information sharing protocols; and
- Regular update calls between the consultant the compensation committee chair to "check in" and ensure they are meeting expectations and understand any issues or concerns.

Once the outside advisor is able to establish that they are independent and conflict free, it is important to note that their independence need not be compromised by having a good working relationship with management. To be effective, the compensation consultant needs to know various characteristics of the executives, individually and collectively. Attracting, retaining, and motivating are often behavioral, as well as economic and cultural, challenges. The consultant needs to work closely enough with management to ensure that programs are successful, but be independent enough to let the committee and the executive team know when an issue is identified.

About the Author

Wes has 25+ years advising on executive compensation, including competitive pay and performance analyses and annual/long-term incentive design, with an industry focus on energy, clean technologies, finance, and healthcare.

About Pearl Meyer

Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term success. Our strategy-driven compensation and leadership consulting services act as powerful catalysts for value creation and competitive advantage by addressing the critical links between people and outcomes. Our clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private organizations to the Fortune 500.