Executive compensation in health care organizations, especially tax-exempt organizations, has come under increasing scrutiny over the past few years. That is likely to intensify with Congressional efforts to reshape health care and health insurance and with publication this year of more transparent information on executive pay in the new IRS Form 990. If widespread concern over the rising cost of care weren’t excuse enough, debate on legislative proposals has already given federal legislators added impetus to scrutinize and regulate pay of nonprofit health care executives.

Federal regulation of executive compensation in financial institutions receiving TARP funds suggests that nonprofit hospitals and health systems may face new constraints as Congress debates health care reform and decides how to pay for it. The health care industry, after all, depends significantly on federal funding of Medicare and Medicaid and reaps significant benefits from tax exemption. Even health insurers, tax paying or not, are likely to face intense scrutiny of their executive pay practices, because of a perception that executive pay is linked to rising premiums and costs of care. Efforts to control the cost of health care could lead Congress to limit pay for executives of nonprofit and for-profit providers, insurers, and even manufacturers, to avoid rewarding them for making profits from publicly funded health care programs.
This paper identifies some of the changes we are likely to see as well as some of the changes boards of nonprofit health care providers and insurers should consider to minimize the case for further scrutiny and regulation of their executive pay practices.

Rules initially applied to one setting have a way of getting applied to other settings. Legislators have already proposed extending to tax-exempt health care organizations the $500,000 limit on executive pay at banks receiving TARP funds and the “clawback” provision in Sarbanes-Oxley, requiring that CEOs and CFOs pay back bonuses if financial results need to be restated. And the SEC’s new “say on pay” rule could shape an expectation that policyholders of mutual companies, or members of HMO cooperatives, and maybe even stakeholders of nonprofit providers, like the medical staff, have a right to a non-binding vote on executive pay.

Concern about the cost of universal health care coverage is also likely to increase scrutiny at state and local levels, too, of the pay practices of nonprofit hospitals and systems, other providers, and health plans. The new initiative of the attorney general of Massachusetts to investigate executive compensation practices of nonprofit health care systems and insurers is just one of the first signs of this.

Boards of many nonprofit health care organizations have begun to eliminate elements of their executive compensation programs that are most vulnerable to criticism. There is a long-term trend to eliminate perquisites. But there is still a raft of practices that are likely to attract more criticism than they are worth. Since legislators and regulators are attuned to the perceptions of voters, anything that treats executives notably better than other employees is bound to attract unwanted attention. Boards would be wise to streamline their executive compensation programs to make them less tempting targets.

**Issues**

Since nonprofit hospitals, health systems, and nursing homes are organized as tax-exempt charities under federal tax law, Congress and other regulators think such organizations should pay their executives less than private organizations. Many in Congress and in state governments think that hospitals and health systems are not doing enough to deserve their tax exemptions. (A number of state legislatures, for example, have considered setting minimum requirements for charity care or community benefit.)

Since these organizations are dependent on government funding for Medicare and Medicaid, and most Americans think that health care costs too much, Congress is likely to use health care reform efforts as an excuse to constrain executive pay in health care organizations that benefit from tax exemptions as well as federal “subsidies” for health care. Some proposed amendments already attempt to use that venue to limit executive compensation.

The Senate Finance Committee has led the charge on investigating and proposing remedies to what it sees as excesses in executive compensation at tax-exempt charities. Senator Grassley has proposed eliminating the provision for a “presumption of reasonableness,” which shifts to the IRS the burden of proving that compensation is excessive. The recent IRS report on executive compensation shows that boards of most large tax-exempt hospitals and health systems are following the procedure to establish the presumption of reasonableness—but critics see that as a sign that these organizations are paying so much that they need to avail themselves of this maneuver.

The Senate Finance Committee issued a report several years ago outlining its ideas for reforming executive pay in tax-exempt organizations. So did the Panel on the Nonprofit Sector, a collaborative effort chartered by the committee and the Joint Committee on Taxation.

Fortunately, Congress has in the main limited its regulation of what it views as excessive compensation in the nonprofit sector to tax rules and penalties that are difficult to impose because of the presumption of reasonableness. The IRS has found countless instances of compensation it believes to be exceptionally high, but it has so far successfully imposed penalties on only a few organizations.

If and when enacted, federal health care reform legislation is not likely to be generous to providers. Congress will need to pay for universal coverage by limiting how much it pays and what it pays for. Urban teaching hospitals will probably see Disproportionate Share payments eliminated. The cutbacks we’re now seeing in
state Medicaid reimbursement and SCHIP programs may never be restored, since states may be obligated to cover their share of Medicaid costs for more people than before. This means that hospitals and health systems will need to look hard to find ways of reducing costs. We’re already beginning to see reductions in executive pay programs as a result of the recession. There are likely to be more if the recession lasts long and if health care reform makes it harder for hospitals to break even.

Many nonprofit organizations have been pressing their luck by imitating patterns in the for-profit sector and being extraordinarily generous to their CEOs, in particular. Given the rising chorus of complaints from politicians—who do control funding for health care, after all, and shape tax policy—boards would be wise to take this opportunity to reform executive pay by (1) avoiding the types of practices that attract and deserve the most criticism and (2) rewarding executives for outcomes that represent prevailing public views of what nonprofit health care organizations’ goals should be.

Health insurers, nursing homes, and suppliers of medical devices and pharmaceuticals are less likely than hospitals to be subject to new federal constraints on executive pay, but it’s possible that any organizations that participate in Medicare, receive tax exemptions, or appear to contribute significantly to the rising cost of care could get caught up in frenzied efforts to limit health care costs. For instance, Congressional committees in both the Senate and the House have begun investigations of executive pay at health insurers, coincidental with debates on health care legislation. This may be the first sign that Congress is willing to extend regulation of executive pay to the health insurance industry. The Obama administration has given signals, too, that it would support efforts to constrain executive pay in the for-profit sector.

Fortunately, new regulations are rarely totally new: they are usually modifications or enhancements of existing regulations. For this reason, it makes sense to question whether and how the new regulations on TARP recipients could be applied to tax-exempt organizations or to participants in publicly funded health care programs, and whether and how intermediate sanctions regulations could be tightened. Admittedly, tax exemptions and payment for services rendered under Medicare or Medicaid are totally different from the extraordinary assistance given to banks, insurers, and other firms in relation to the current economic collapse, but given the history of criticism of excessive compensation in tax-exempt health care, it’s not improbable that the confluence of the economic crisis, budgetary concerns, and health care reform will lead to new regulations on executive pay in the health care industry.

Examples of Egregious Compensation

The worst examples of egregious compensation aren’t necessarily instances of too much pay. Instead, they are pay of the wrong kind.

- One of the worst comes from evergreen employment contracts, which allow executives to collect severance on retirement, if they play their hands right. Paying three years’ severance to an executive who is asked to retire at age 65 or 68 isn’t going to seem right to anyone, regardless of the circumstances.

- Enhancing a supplemental executive retirement plan (SERP) at the last minute is bound to look like an inappropriate gift to a retiring executive, and a misallocation of charitable resources.

- Providing a retirement benefit that pays much more than 60 percent of final average salary and bonus or more than 70 percent of final average salary is likely to look excessive to any impartial observer. Too many defined benefit SERPs don’t have offsets for at least one or more forms of deferred compensation, and too many defined benefit restoration plans use W-2 compensation as the basis for calculating benefits, so the total retirement benefit is often more than what is called for by the SERP formula.

- Counting last-minute cash-outs of deferred compensation and unused paid time off as part of the base used in determining SERP payments will look unfair to any impartial observer.

- Paying tax gross-ups on SERPs, because they are taxed as lump sums, or on personal use of cars or other perquisites, will look far worse than paying a richer retirement benefit, a higher car allowance, or a higher salary, because employers don’t otherwise pay employees’ taxes.

- Providing post-retirement benefits or perquisites, such as post-retirement medical benefits, post-retirement auto allowances, or post-retirement office expenses, will look worse than paying a slightly higher retirement benefit.
Lessons from Constraints Imposed on TARP Recipients

Despite the uproar over bonuses paid by AIG, Merrill Lynch, and Goldman Sachs, Congress has refrained from setting strict limits on executive pay, and it has so far limited the new regulations to recipients of TARP funds, troubled firms that sell assets directly to the Treasury, and offshore tax havens owned by tax-exempt investors. Instead, it has prohibited incentives that encourage excessive risk taking or manipulation of earnings, limited the deductibility of compensation to $500,000 per executive, prohibited payment or accrual of bonuses to highly paid executives except in the form of restricted stock that cannot be redeemed until government loans have been repaid, prohibited payment of golden parachutes (severance on change of control) to the top five executives, prohibited tax gross-ups, and required recovery of bonuses paid on the basis of materially inaccurate financial statements or other criteria used in determining bonuses.

But it also requires certification that executive compensation programs comply with regulation and requires compensation committees to explain how they ensure that executive compensation programs don’t encourage excessive risk taking or manipulation of earnings. It discourages perquisites and unnecessary spending on entertainment and office accoutrements by requiring disclosure of perquisites and by requiring boards to establish policies on reimbursement of expenses for “luxurious items.” It also requires a non-binding shareholder vote on executive compensation.

Another little noticed provision is that the committee’s report on use of consultants must disclose the peer group used in establishing executive pay and indicate the lowest level of comparability data considered in setting pay. This provision is intended to discourage consultants from cherry picking a peer group of high-paying organizations and discouraging boards and their compensation committees from setting compensation at the 75th percentile. Many committees look only at the 75th percentile in setting pay, and many intentionally select peer groups of high-paying organizations. (This echoes concerns expressed by IRS spokespeople regarding peer groups and compensation targets in the tax-exempt sector. It also reflects the views of some regulators that paying anyone more than median is excessive.)

Since the new rules indicate what Congress considers excessive, it’s easy to see how they could be applied to tax-exempt health care organizations. Pay could be limited to $500,000, perhaps allowing exceptions if providers are meeting minimum requirements for charitable care or community benefit. Incentive plans could require certification that they do not undermine quality of care, discourage charitable care, or encourage overcharging public programs for care. Severance could be prohibited on change of control, or limited to one year (as in an earlier version of the regulation), or taxed entirely as deferred compensation (as a lump sum at termination). Bonuses could be recoverable if they are tied in part to Medicare reimbursement later denied. Perquisites and meetings at resorts could be discouraged. Compensation committees could be required to publish reports justifying their decisions and explaining their use of comparability data in setting executive pay.

What drove Congress to impose the new rules on banks and General Motors, however, was public outrage over the size of bonuses paid by firms that had helped cause the recession. The rules themselves are a compromise with members who didn’t want to impose any limits.

If no comparable excesses come to light while health care reform is on the table, there won’t be any comparable public outrage. Without public pressure, Congress is likely to recognize that it doesn’t know how to set limits or constraints on executive pay at hospitals and health systems. It’s far more likely to tinker with intermediate sanctions, perhaps by raising the fines for excess benefit transactions, perhaps by prohibiting use of comparability data from for-profit organizations, perhaps by eliminating the rebuttable presumption altogether to make it easier for the IRS to pursue claims of excessive compensation.

On the other hand, the Federal Reserve has begun working on new regulations for the banking industry as a whole, intending to discourage compensation practices that promote excessive risk taking. And the Conference Board has announced a voluntary effort by blue-chip firms to reform executive compensation in general industry. These efforts are based on the principles underlying the rules for recipients of extraordinary federal aid. They discourage overemphasis on short-term incentives, encourage longer-term incentives, and discourage multi-year employment contracts and rich severance benefits. If these initiatives proliferate, it will become more likely that these
principles will be extended to health care providers and health insurers, whether as regulation or as best practices enforced in other ways.

**Proposals from Senate Finance Committee**

The Senate Finance Committee has issued a draft set of proposals calling for eliminating the presumption of reasonableness for joint ventures between for-profits and tax-exempt hospitals and eliminating the initial contract exception altogether, out of concern that it is being abused. It also calls for increasing the penalty on anyone—including board members—who knowingly approves an excess benefit transaction from 20 percent to 25 percent of the excess amount. The penalty was originally established at 10 percent of the excess amount, then increased to 20 percent by the Pension Protection Act of 2006. An increase to 25 percent would put it on par with the first-tier penalty for the recipient of the excess benefit.

Other draft Senate Finance Committee proposals include eliminating perquisites such as reimbursement for country clubs or spouse travel and loans to executives, and making publicly available the surveys on executive compensation used in setting executive pay. One proposal already adopted is the required reporting on governance, community benefit, and charitable care on IRS Form 990.

Given the questions on perquisites, severance, and supplemental retirement benefits in the new Form 990, it is likely that they will continue to be a focus of regulators’ attention. This would be an easy arena for constraining executive pay, since perquisites are hard to justify as competitive necessities and attract far more passionate criticism than they deserve, given how little they cost. They are declining rapidly in prevalence and don’t fit the espoused values of most tax-exempt health care organizations or the values of the communities they serve.

Senator Grassley has proposed eliminating the rebuttable presumption of reasonableness, out of concern that this makes it too difficult for the IRS to pursue intermediate sanctions on excessive compensation. This proposal dates back to recommendations in 2005 from the Joint Committee on Taxation and the Panel on the Nonprofit Sector. It would shift full responsibility for justifying the reasonableness of pay to the employing organization and allow the IRS to more easily impose penalties or negotiate settlements, as the only other recourse would be going to court. In his proposal, Senator Grassley indicates disapproval of using comparability data from the for-profit sector to justify paying executives of nonprofit organizations at the same level as for-profit executives.

Senator Blanche Lincoln has proposed limiting the deduction for compensation of executives of health insurers to $500,000, if they provide insurance coverage under the new mandate. This is the same limit set for banks receiving TARP funds, but it does not allow for paying more in restricted stock or in deferred compensation.

**Proposals from the Conference Board**

The Conference Board, an organization of blue-chip firms on the national stock exchanges, has recently issued a set of recommendations for restraining executive compensation programs, in acknowledgement that Congress will impose changes if large publicly traded firms don’t voluntarily make the changes first.

The recommendations include avoiding controversial pay practices, avoiding complex programs that are difficult to understand, avoiding overly competitive pay levels, and asking the board as a whole to approve compensation programs and CEO pay. The report discourages perquisites, unnecessarily generous severance benefits, unnecessary use of employment agreements, giving the CEO more severance than other executives, change-of-control provisions that entitle a CEO to severance on voluntary resignation, tax gross-ups, supplemental retirement plans that treat the CEO or other executives better than other long-service employees, and richer life insurance benefits than those provided to other employees, among other things. It also discourages setting compensation targets above median or average without special justification.

**Eliminating the Rebuttable Presumption of Reasonableness**

The report on the IRS’s Hospital Compliance Project noted that almost all of the 478 respondents seemed to be following the process in IRC Section 4958 for establishing a presumption that executive pay is reasonable. Instead of viewing this as evidence of compliance, some critics took it as evidence that tax-exempt hospitals are paying so much that they need to take these steps to protect themselves from intermediate sanctions.

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1 Reports from both entities also recommended elimination of two other safe harbors from intermediate sanctions, the exception for initial contracts and the provision that parties approving a transaction could be fined only if they knew the transaction amounted to an excess benefit.
There has been ample criticism of this safe harbor, which makes it difficult for the IRS to challenge executive compensation as being unreasonable. Some legislators have proposed eliminating the presumption. Given regulators’ continuing concern over high pay levels in the tax-exempt sector, and their dissatisfaction with this safe harbor, it’s not unlikely that they will try to refine the existing rules in IRC Section 4958 by increasing penalties for excess benefit transactions, making it harder to shield executive pay from intermediate sanctions, and limiting the use of comparability data from the for-profit sector and from peer groups explicitly chosen to represent only high-paying organizations. Eliminating the presumption as a safe harbor would make compensation committees very skittish, worried about the risks that their hospitals could be easily embarrassed by the IRS and that they themselves could be fined.

Constraints on Incentive Compensation Programs

A series of private letter rulings going back to the 1970s provide the IRS view that incentive compensation plans in the tax-exempt sector don’t violate prohibitions against private inurement and private benefit only if they are designed to support the organizations, tax-exempt mission, are controlled by a disinterested board or committee, and don’t result in unreasonable compensation. (The rules for the presumption of reasonableness are just refinement of the earlier guidelines on incentive compensation.)

But recent criticism of executive pay in the tax-exempt sector could lead Congress or the IRS to enforce the first provision, that incentive plans must be designed and used to support the organization’s tax-exempt mission. This guidance hasn’t been taken seriously by many boards, whose members have been far more focused on rewarding good financial performance than rewarding quality of care or community benefit. Few incentive plans are linked in any meaningful way to providing community benefit. Most put some emphasis on quality of care, but until recently quality of care has been weighted much less than financial performance. Only recently have some organizations put as much or more weight on quality of care as on financial performance. And most incentive plans have a circuit breaker that ultimately makes the plans a profit-sharing mechanism, since they pay nothing unless financial performance is reasonably good.

“Say On Pay”

In July the Treasury asked Congress to pass “say-on-pay” legislation requiring all publicly traded companies to give shareholders a non-binding vote on executive compensation. It calls for disclosure of and a non-binding vote on any golden parachutes related to merger or acquisition of a publicly traded firm. It reinforces requirements already in place at the stock exchanges for a compensation committee made up entirely of independent directors, with authority to retain independent compensation consultants, independent legal counsel, and other independent advisors, and adds a requirement that the committees disclose in proxy statements whether they have used a compensation consultant. It also calls for the Securities and Exchange Commission to establish standards for independence for consultants, legal counsel, and other advisors, to conduct a study of the use of compensation consultants meeting the standards, and to report to Congress on the results of the study.

Requirements for publicly traded firms often become best practices for private firms, tax-paying nonprofits, and tax-exempt organizations. This “say-on-pay” legislation opens the door to requests from members or stakeholders of nonprofit organizations to have a right to vote on executive pay. The shareholder equivalent in many health systems is a church body or a religious order; in public hospitals, it is voters; in community hospitals, it could be the voluntary medical staff. In a mutual insurer or a cooperative HMO, it could be policyholders or members.

The separate vote on golden parachutes could be easily turned into a prohibition against enhanced severance in relation to a merger or acquisition, or into special tax treatment of severance increased shortly before a merger or acquisition, more onerous than the new rules in Section 409A.

Comparisons of Pay in the For-Profit and Nonprofit Sectors

The IRS and courts have for a long time held the view that data from the for-profit sector is relevant to showing the reasonableness of pay in the nonprofit sector. The intermediate sanctions regulations themselves allow for use of comparability data from the for-profit sector in establishing the presumption of reasonableness.
Recently, however, the IRS and congressional critics have suggested that for-profit comparisons alone shouldn’t suffice, if they aren’t supported by comparisons from nonprofit organizations, and shouldn’t be used in the absence of a compelling rationale for using for-profit comparisons. This implies, for example, that comparisons with for-profit hospitals may make more sense in the South than in the North, since for-profit hospitals are more numerous in the South than in the North. It implies that comparisons with for-profit data may make more sense for chief financial officers or chief information officers than for chief executive officers, since CFOs and CIOs cross from one sector to the other more often than CEOs.

Most tax-exempt hospitals and health systems don’t use data from the for-profit sector in determining executive pay levels. When they do, it is often limited to staff executive positions (e.g., finance, human resources, information technology, marketing) in organizations that have recruited staff executives from the for-profit sector. Surveys of executive compensation in hospitals and health systems usually don’t have much data from for-profit organizations. (In some segments of the industry, such as managed care, long-term care, senior housing, and medical practices, for-profit organizations play a much bigger role, so compensation surveys tend to be heavily weighted toward for-profit organizations.)

The IRS is already looking at the use of for-profit data in establishing compensation levels. Most hospitals and health systems don’t use for-profit data this way, but some have used it to justify extremely rich annual and long-term incentives.

It would not be surprising if Congress or the IRS tries to restrict the use of comparability data from the for-profit sector in justifying pay levels in the tax-exempt sector.

What Should Boards Change to Build a Case against Further Constraints?

Most boards of tax-exempt health care organizations have, in the main, been moderately conservative in setting executive compensation. Some have not, however; and others have approved rich programs without really understanding how egregiously rich they are. Unfortunately, the exceptions give politicians and the press plenty of reason to get excited about excessive compensation.

The usual advice is to carefully follow the rules the IRS prescribes as best practices in governing executive compensation in the tax-exempt sector, the rules for establishing a rebuttable presumption of reasonableness, a provision of the 1996 Taxpayer Bill of Rights 2, now embedded in IRC Section 4958. These rules are easy to follow, and most sophisticated boards are at least trying to follow them.

Unfortunately, this probably isn’t enough, since by following these rules, boards look as if they are worried that executive compensation is excessive, or that it is high enough that the IRS might think it is excessive.

What gets people excited isn’t just the absolute level of pay but the type of pay. Perquisites are more incendiary than benefits; bonuses, more than salary or benefits. Cars or car allowances and country club memberships and tax gross-ups on perks are bound to attract criticism, even though they don’t cost all that much, because the public can’t see any reason to pay for cars for executives when hospitals are asking low-paid employees to shoulder more of the cost of medical benefits. So are severance benefits and supplemental retirement plans, which are often far richer for executives than for other employees.

Compensation committees should ask three questions they rarely ask in deliberations on executive compensation:

- Does this proposal support our tax-exempt mission?
- Does this proposal allocate scarce funds in the best possible way?
- Does this proposal expose the organization unnecessarily to adverse publicity from regulators or our stakeholders?

The committees that do this best are at religious systems, where members of the sponsoring order set the tone for governance with their concerns for social justice. What it takes is careful consideration of competing claims on scarce resources, balancing concern for the leaders trustees interact with regularly with concern for employees, who are seeing their retirement benefits cut and are being asked to shoulder more and more of the cost of medical benefits.
The watchwords today in governance are transparency and full disclosure. The implication is that compensation committees should disclose executive compensation in detail to the board as a whole, a relatively new practice in the tax-exempt sector, and to the public, as the new Form 990 requires. The implication may extend to disclosing executive pay to the medical staff and employees.

The more important implication is that compensation committees shouldn’t approve anything they aren’t willing to defend to the board as a whole, or to sponsors, the medical staff, employees, the community, or the legislators and regulators who fund public programs.

Too often compensation committees approve what the CEO wants, despite any reservations they may feel or express. Trustees want to avoid unnecessary friction, but even more they want to keep the CEO satisfied, so that pay doesn’t undermine morale of the leadership team.

Recognizing that the fuller disclosures required by the new 990s will make it easier to understand the special deals given to executives, boards should expect physicians, employees, unions, and politicians to question the appropriateness of anything that treats executives better than other employees, especially as hospitals are laying off employees, reducing their retirement benefits, and asking them to shoulder more of the cost of health care benefits.

Here are some specific things compensation committees can do to lower the risk of alienating regulators, thereby provoking further regulation:

• Eliminate perquisites that are lightning rods for criticism, like cars and car allowances, reimbursement for country clubs, first-class travel, post-retirement medical coverage (if for executives only), and tax gross-ups.
• Don’t give executives better health care benefits than other employees; avoid paying for their share of premiums and reimbursing them for co-pays and deductibles.
• Don’t promise to continue funding executive benefits in the future, since you don’t do that for other employees.
• Review and refine the formulas for defined benefit SERPs, to make sure that changes in the underlying pay program don’t drive up the liability in unanticipated ways.
• Keep severance commitments reasonable, and avoid promising unusually generous severance to any new hires. Avoid enriching severance commitments in relation to mergers and acquisitions.
• Avoid offering retention incentives to executives who are already well paid, unless it is highly likely that they might leave otherwise, and only if their departure would be a crippling loss for the organization.
• Make sure that the value of defined benefit SERPs isn’t affected by last-minute cash-outs of PTO or last-minute withdrawals of deferred compensation.
• Renegotiate employment agreements several years before retirement to ensure that you don’t need to pay severance to a retiring executive.
• Reshape incentive plans to put more weight on clinical quality, patient safety, and community benefit and less weight on financial performance.
• Consider redefining any “circuit breaker” or funding requirement for an executive incentive plan to include a hurdle rate for clinical quality or patient satisfaction, rather than use only one for financial performance.
• Redefine goals on financial performance to focus on cost-effectiveness instead of profitability.
• Add a “clawback provision” requiring the CEO and CFO, at least, to repay bonuses if they were based on results that were intentionally misrepresented—but apply to misrepresentation of clinical quality, patient satisfaction, and community benefit as well as financial results.
• Make some portion of executive compensation contingent on longer-term performance and subject to risk of forfeiture in the event of bankruptcy or other forms of failure.
• Publish an explanation of the compensation philosophy with the 990 statement, to show that the board’s policy is reasonable.
• Ground all statements about executive compensation, including any statements of compensation philosophy and any documents describing executive compensation, in commitments to mission—quality, access, community benefit—in instead of just competitiveness, recruitment and retention, and rewards for performance.

• Make the chair of the board or the compensation committee the spokesperson on executive compensation, not the public relations executive.

• Get board members involved in explaining and justifying the compensation program to the medical staff and state legislators, when necessary and appropriate.

• Get prepared to respond to questions about executive compensation before the 990 is filed each year. Have answers ready for any anticipated questions.

• Deal effectively with pressure from the CEO and don’t let it lead to decisions you’ll eventually regret.

It’s easy to justify paying competitively to attract and retain the caliber of executives needed to lead a large, complex organization. It’s not easy to justify paying for autos or club memberships or first-class travel or tax gross-ups while complaining about inadequacy of funding for Medicare and Medicaid or while telling employees you can’t afford to maintain their benefits at the current level. Streamlining executive compensation programs to make them more straightforward and defensible will lower the risk of being singled out for criticism. If enough organizations do this, it will lower the likelihood of more stringent regulation of executive pay in the nonprofit sector.

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Bibliography


Special Note

The author’s caution in this paper, “Rules initially applied to one setting have a way of getting applied to other settings,” was borne out several months after this writing when the federal health care reform law was enacted. For all health insurers subject to federal income taxation, including those that are nonprofit or otherwise non-investor-owned, the deductibility of executive compensation as a business expense will be limited to $500,000.