

GOODWILL INDUSTRIES

OF THE COLUMBIA WILLAMETTE
Our business is changing lives

GOODWILL INDUSTRIES OF THE COLUMBIA WILLAMETTE, INC.

RESPONSE TO OREGON DEPARTMENT OF JUSTICE AUDIT REPORT

DECEMBER 20, 2005

I. INTRODUCTION

Goodwill Industries of the Columbia Willamette, Inc. (“GICW”) appreciates the opportunity to work with the Department of Justice (“Department”) in addressing the need for standards with respect to the executive compensation practices of Oregon nonprofit organizations. At all times, GICW has acted lawfully, cooperatively, and in good faith. As a result of the cooperation between the Department and GICW, GICW has designed and implemented new compensation principles and procedures that will serve as best practice models for nonprofit organizations throughout Oregon. GICW commends Attorney General Hardy Myers on the diligence and collaborative spirit with which he has approached this work – an effort that will ultimately benefit all Oregonians by strengthening the nonprofits in our community.

GICW serves, as the Department has acknowledged, a fundamental role in the social fabric of Oregon by providing vocational opportunities to people with barriers to employment throughout the state. With an annual payroll, including benefits, of over \$40 million, and currently more than 1,800 employees, GICW is a major and positive presence in Oregon. GICW’s employees and program participants are the best evidence of its successes.

The current relationship between GICW and the Department is the result of the Department’s audit of GICW’s operations, which commenced in April, 2004. The audit focused on two elements of GICW’s operations: program services to the disabled and disadvantaged, and executive compensation. The Department’s findings are reflected in the Audit Report (the “Report”) that it released today. GICW believes that the overwhelming result of this audit has been positive – the Department and GICW have worked together to understand what practices and procedures are appropriate for GICW and other Oregon nonprofits and have developed a plan for implementation. While GICW and the Department have achieved consensus on nearly all areas related to best practices, the parties have agreed to disagree with respect to the Department’s statements in the Report that certain historic practices of GICW were insufficient. GICW feels that it is necessary to set the record straight with respect to those Report findings.

II. GICW PROGRAM SERVICES

GICW is gratified that the Department, after a thorough review of GICW’s program services, was able to “verify the accuracy of total program service numbers and percentages” for

GICW, and that it found that “without exception, GICW’s documentation demonstrated “that its classification of individuals in its programs was accurate” and complied with GICW procedures. GICW is proud of its service to the community and of its procedures in place for ensuring meticulous and accurate record-keeping concerning those services. GICW is conservative in the representations it makes, the accuracy of which the Department verified. But that is not the entire story.

GICW offers hope to job seekers by giving them the opportunity to work in modern, barrier-free, state-of-the-art facilities with the chance to advance. Unlike most social service organizations, GICW is economically self-sustaining in accomplishing its mission. We operate on an innovative, mission-integrated, entrepreneurial model, in which less than 2% of revenues come from government sources.

In keeping with our belief in operating with the highest standards, GICW has been continuously accredited by the Commission on Accreditation of Rehabilitation Facilities (“CARF”) since 1973. CARF regularly conducts a comprehensive review of GICW’s programs. Among the many areas in which CARF found that GICW demonstrated exemplary conformance to CARF’s standards were its “. . . commitment found throughout the organization to provide outstanding support to persons with disabling conditions” and its “. . . work in assisting persons with vocational limitations to secure employment, which is provided free of charge to the job seeker.” CARF also commended GICW for its “. . . excellent business and operations practices. Through much hard work and planning, the business and marketing operations of the organization are highly successful and serve as a model to other similar organizations throughout the country.”

The Report suggests that some changes are needed in how GICW compiles its data on the level of services that it provides. GICW is conservative in reporting its services. There are instances when GICW provides more than one service to an individual. In such cases, GICW reports both services. The Report says this is “appropriate in accounting for services rendered by each of the programs” but results in a “misleading statistic when data about these programs is combined.” GICW employs many different people and provides them with many different services. If, for example, GICW enrolls an individual in a free English class, and later, GICW hires that person, it is reasonable to report the two different services separately, even though they were provided to the same individual. Similarly, GICW believes that it continues to serve an individual as long as that person is employed with the organization. GICW attempts to be scrupulous and act in good faith in its reporting. Nevertheless, it will review its statistical reporting practices, conservative as they are, so that the public will continue to be fully informed. GICW’s purpose in compiling statistics on the people it serves is to assure adherence to its mission.

Finally, GICW serves the community in many other ways that are not identified in the Report, and which are not always immediately apparent or captured statistically. The many additional community services that GICW does not routinely report include:

1. Christmas presents to families through our Goodwill Cares program; Annual Christmas and Thanksgiving meals to all employees; Christmas bonuses to all employees along with gift certificates to our stores.
2. Mentoring and strategic planning to other nonprofit organizations based on our entrepreneurial, mission-integrated model;

3. Donations of medical supplies to Northwest Medical Team; eyeglasses to Lions Club for distribution; cosmetics to women's shelters; books to the Coffee Creek Women's Correctional Facility library.
4. Participating in voucher programs with more than 30 local service agencies to provide emergency clothing and household goods. Recently, GICW helped hurricane evacuees with clothes, personal hygiene items, furniture, personal assistance in locating housing, obtaining benefits, and staffing a hurricane relief center. GICW staff volunteered additional time and money to assist in these efforts.
5. Offering a free curriculum based retail training course for other Goodwill organizations as well as other local nonprofits.
6. Investing over \$65 million in the community in the last 13 years as GICW continues to develop top-quality stores and work places for our employees and customers.

III. EXECUTIVE COMPENSATION

GICW prides itself on being a responsible corporate citizen. To its knowledge, GICW is in full compliance with all applicable laws and regulations governing its operations, including those governing the determination of executive compensation. GICW is therefore troubled by the Report's conclusions with respect to executive compensation. The Report's conclusions, tellingly, do not point to a single law or regulation with which GICW has failed to comply. GICW shares the Department's desire to ensure that Oregon nonprofit organizations pay no more than reasonable compensation to their executives and that Oregonians continue to trust the fiscal stewardship of the charities that they support. To this end, GICW has worked with the Department in recent months to develop a compensation-setting process and written compensation-setting principles in accord with current and emerging best practices that GICW hopes will serve as a model for other Oregon nonprofit organizations. It should also be noted that the Department's criticism of past compensation (1997 to 2004) is made in light of emerging standards. The compensation at issue has been publicly available for each of those years and has been subject to independent audit.

GICW has established a Compensation Committee, comprised solely of members of GICW's Board of Directors, who, as provided by the GICW Compensation Committee Charter (attached to the Department's Report): (1) are completely independent and unrelated to any individual compensated by GICW; (2) will retain an executive compensation professional on an annual basis to provide comparability data and recommendations concerning the compensation of the president and other members of the GICW executive team; (3) will review the performance of the GICW president and executives; and (4) will present to the full GICW Board of Directors recommendations on the compensation of the president and will approve the compensation of all other members of the GICW executive team. The GICW Board has also approved a written, Total Compensation Philosophy, which reflects the guiding compensation-setting principles that GICW will use in order to recruit and retain outstanding executive leaders who have a deep understanding of, and commitment to GICW's wide range of service programs and self-sustaining economic model.

A. There Is No Guidance Under Oregon Law

As the Report itself states, "Oregon law provides little explicit guidance" with respect to the determination of executive compensation for a nonprofit corporation. As the Report further notes, the audit of GICW "represents the first time that [the Attorney General's Office] has addressed the

issue in some detail.” The Department, to GICW’s knowledge, has provided no formal guidance and issued no opinions regarding executive compensation for nonprofits, and the Report cites to none. Rather, the Report notes that the “principles are evolving” regarding standards in the area. GICW concurs completely with the Report’s statements regarding the lack of Oregon law in the area and the evolving nature of best practices concerning nonprofit executive compensation.

Under Oregon law, as under the law in other states, a nonprofit corporation may pay reasonable compensation to its executives. *See* OR. Rev. Stat. §§ 65.001(12), 65.551 (an Oregon nonprofit corporation may not make distributions, but payment to an officer for services performed in furtherance of the corporation’s purposes is not a distribution); *cf.* Revised Code of Washington 24.03.030 (a nonprofit corporation “may pay compensation in reasonable amount” to its officers “for services rendered”); California Corp. § 5235 (nonprofit corporation’s board may fix “reasonable and just” compensation of an officer).

The issue is what constitutes reasonable compensation. It is on this point that the Department and GICW part company, with respect to the compensation paid to GICW’s president during the period 1997-2004. The Department has not identified any Oregon law or regulatory authority, and GICW is aware of none, that sets out the standards that a nonprofit corporation must or should apply in determining what is reasonable executive compensation. When no Oregon authority appears on point, it is appropriate to look to federal law addressing the same issue. *See Badger v. Paulson Inv. Co., Inc.*, 311 Or. 14; 803 P.2d 1178 (1991); *University of Oregon Co-Op. Store v. State, Dept. of Revenue*, 273 Or. 539; 542 P.2d 900 (1975); *Bailey v. Commission*, 2 Or. Tax 399 (1966).

There is a good deal of authoritative federal law in the area, as set out in detail below. Under the federal law, whether compensation paid by a tax-exempt organization is reasonable must be determined in light of all of the facts and circumstances. *See, e.g., World Family Corp. v. Commissioner*, 81 T.C. 958, 969 (1983) (“The law places no duty on individuals operating charitable organizations to donate their services; they are entitled to reasonable compensation for their efforts”).

The Report identifies three areas of concern: (1) the process used in establishing executive compensation; (2) the use of data on compensation paid by comparable for-profit organizations in establishing reasonable compensation paid by a nonprofit; and (3) the total amount and composition of the compensation paid to GICW’s president. Each issue is addressed below to demonstrate that GICW complied in all respects with existing law in both its process and the ultimate level of compensation paid.

B. Process for Determining Compensation

1. Independent Board Members Set GICW’s Executive Compensation

The starting point under the federal law in establishing a procedure for determining reasonable executive compensation – a point that the Report does not discuss – is ensuring that the compensation decision is made by an independent body.

In the federal law, the “intermediate sanctions” rules set out optional procedures that a tax-exempt nonprofit organization may choose to follow in order to create a presumption that

compensation that it pays to an executive is reasonable.¹ Treasury Regulation § 53.4958-6. The procedures involve three steps: (1) approval by a disinterested board or committee; (2) reliance upon “appropriate data as to comparability”; and (3) written documentation of the decision, including a description of the comparability data relied upon. *See* Treasury Regulation § 53.4958-6(a).

The first of these steps is approval by an independent, disinterested body. GICW is governed by a board of 12 individuals who are broadly representative of the community. None of the directors is related to GICW’s president or any other member of senior management, and none of the directors are related to each other. All of GICW’s directors volunteer their time, receiving no compensation from GICW, and are deeply committed to GICW’s important work in the community. They have no conflict of interest in setting executive compensation and receive no personal benefit with respect to GICW’s payment of executive compensation. GICW’s executive committee reviewed and approved GICW’s senior executive compensation on an annual basis, with reference to the president’s achievement of organizational goals.

2. **A Board May Permissibly Delegate Approval of Executive Compensation to Its Executive Committee**

GICW’s board has historically delegated senior executive compensation decisions to its executive committee, comprised of five independent board members with substantial business experience. The board’s delegation to its executive committee not only fully complies with Oregon law – it is *clearly authorized* under Oregon law. The Oregon Nonprofit Corporation Act provides that “a board of directors may create one or more committees of the board of directors which exercise the authority of the board of directors, and appoint members of the board to serve on them.” OR. Rev. Stat. § 65.354(1). The statute sets out an exclusive list of actions that the board may not delegate to a committee, and that require full board action. That list includes such actions as electing directors to fill vacancies and amending bylaws. OR. Rev. Stat. § 65.354(5). That list does *not* include approving executive compensation. Nothing in the statute even remotely suggests that a board may not delegate the authority to set executive compensation to a committee of the board.

At the federal level, Treasury regulations *explicitly approve* a charitable organization board’s delegation of authority to approve executive compensation to a committee of the board. The regulations define an “authorized body” for purposes of approving a compensation decision to include:

A committee of the governing body, which may be composed of any individuals permitted under State law to serve on such a committee, to the extent that the committee is permitted by State law to act on behalf of the governing body

Treasury Regulation § 53.4958-6(c)(1)(B) (emphasis added).

The only authority that the Department cites for its statement that executive compensation should be approved by the full board is a 2005 publication titled “*Dollars and Sense: the Nonprofit Board’s Guide to Determining Chief Executive Compensation*,” published by the BoardSource

¹ The Treasury Regulations relate to provisions under Internal Revenue Code § 4958, enacted in 1996, which imposes excise taxes on officers and other persons with substantial influence over an organization who receive an “excess benefit” from the organization. Organizations are not required to follow the rebuttable presumption procedures, but by doing so they can create a presumption that may protect the officer or other insider from excise tax liability.

organization and written by two consultants. (Obviously this publication was not available to GICW during the time period under audit, because the Department's audit commenced in April 2004.) BoardSource's publications may be a valuable source of background to inform a nonprofit board's decisions. Such publications have no legal authority, however, and do not purport to be authoritative on legal matters. Moreover, the publication cited specifically contemplates that a nonprofit's board may, and commonly does, delegate compensation matters to its executive committee:

If the board wishes to delegate compensation matters to a smaller committee but does not have the desire or personnel to form a separate compensation committee, *chief executive and staff compensation may be handled by the board's executive committee*. In the university community, for example, a 2003 Quatt Associates survey found that . . . among those without compensation committees, *79.3 percent delegated chief executive compensation matters to the executive committee*, and only 20.7 percent assigned them to the full board.

Dollars and Sense at 2 (emphasis added).

As the Report notes, GICW has adopted a Compensation Committee Charter which provides for full board review and approval of the president's compensation. In December 2005, the full GICW Board employed this procedure in approving the president's 2004 incentive compensation and will apply it for future compensation decisions involving the president. GICW agrees that full board involvement in compensation decisions is an appropriate policy in many circumstances, and desires to ensure that its practices are not only fully compliant with applicable law, but are also consistent with and sensitive to emerging best practices in nonprofit governance. The important point is that GICW's past procedure of delegating authority to approve executive compensation to the board's executive committee fully complied with all applicable law.

C. Legal Authority Specifically Authorizes the Use of For-Profit Comparables

As the Report states, state law is silent on the use of for-profit comparables in setting a nonprofit's compensation. As noted above, Oregon common law provides that when no Oregon authority appears on point, it is appropriate to look to federal law addressing the same issue. *See Badger v. Paulson Inv. Co., Inc.*, 311 Or. 14; 803 P.2d 1178 (1991); *University of Oregon Co-Op. Store v. State, Dept. of Revenue*, 273 Or. 539; 542 P.2d 900 (1975); *Bailey v. Commission*, 2 Or. Tax 399 (1966).

The federal tax law is the most developed body of law on the issue of the standards for determining reasonable compensation paid by nonprofit corporations. The issue of whether for-profit comparables should be used in establishing nonprofit compensation for federal law purposes has been the subject of considerable national debate in recent years. As noted above, the U.S. Congress added Section 4958 to the Internal Revenue Code in 1996. That section imposes excise tax liability on senior executives and others who have substantial influence over a nonprofit organization and who receive an "excess benefit" from the organization, such as compensation that exceeds reasonable compensation. In this context, Congress explicitly considered the question of whether it is appropriate for a nonprofit organization, in setting executive compensation, to refer to compensation paid by for-profit organizations as comparables. The first draft of the legislation, prepared by the U.S. Treasury Department, provided that comparability data for establishing reasonable compensation should be limited to compensation arrangements of other tax exempt

organizations. Tax Administration of Public Charities exempt under Sec. 501(c)(3): Hearings before the Subcommittee on Oversight of the House Committee on Ways and Means, Serial 103-39, 103rd Congress, 1st Session (1993).

The U.S. Congress rejected this approach, however. The resolution of the issue is set out in the legislative history to Section 4958. Specifically, the House Report states explicitly that it is the broader universe of for-profit and nonprofit organizations that must be considered in establishing reasonable compensation. The House Report provides that compensation paid to a nonprofit executive is presumed to be reasonable if the compensation was approved by an independent board or committee who obtained and relied upon:

Appropriate data as to comparability (*e.g.* compensation levels paid by similarly situated organizations, ***both taxable and tax exempt, for functionally comparable positions . . .***)

H. Rep. No. 104-506 (1996) at 41 *reprinted in* 1996 U.S.C.C.A.N. 1142 (emphasis added). The legislative history further notes that “the Committee intends that an individual need not necessarily accept reduced compensation merely because he or she renders services to a tax-exempt, as opposed to a taxable, organization.” *Id.* at 56, n.5. The policy reasons for this are obvious: if tax-exempt organizations are to attract the best qualified employees and to compete with for-profit employers for such employees, they must be able to pay comparable compensation for comparable positions.

The Treasury Regulations under Section 4958 reflect the express Congressional intent. Treasury Regulation § 53.4958-4(b)(1)(ii)(A) provides that for the purpose of determining reasonable compensation for an executive, the value of the individual’s services is deemed to be “the amount that would ordinarily be paid for like services ***by like enterprises (whether taxable or tax-exempt.)***” Likewise, Treasury Regulation § 53.4958-6(c)(2)(i) provides that appropriate comparability data includes “compensation paid by similarly situated organizations, ***both taxable and tax exempt,*** for functionally related positions” (emphasis added).

Similarly, in assessing the reasonableness of compensation paid by a nonprofit organization, the Treasury Regulations, the Internal Revenue Service and federal courts have looked to the standards that apply in determining reasonable compensation for purposes of a for-profit employer’s deduction of the compensation expense under Section 162 of the Internal Revenue Code. *See* Treasury Regulation § 53.4958-4(b)(1)(ii)(A) (providing that “Section 162 standards apply in determining the reasonableness of compensation.”) Internal Revenue Manual Section 76.3.11.4.3(4-1-03). *See also United Cancer Council v. Comm’r*, 109 T.C. 326 (1997) reversed on other grounds, 175 F.3d 1173 (7th Cir. 1999); *Truth Tabernacle Church, Inc. v. Comm’r*, 57 TCM 1386, 1389 (1989); *John Marshall Law School v. U.S.*, 81-2 USTC ¶ 9514 (Court of Claims Trial Division), *aff’d*. 228 Ct. of Claims 902 (1981); Internal Revenue Exempt Organizations Continuing Professional Education Textbook, “Reasonable Compensation” (Fiscal Year 1993) at 200. The legal standard accordingly is *not* different for what constitutes reasonable compensation paid by a for-profit organization and a tax-exempt organization.

The Internal Revenue Manual, which sets out procedures for IRS agents to follow in conducting audits, lists the following factors for consideration in determining whether a charity has paid reasonable compensation:

- Duties performed;
- Amount and type of responsibility;

- Time devoted to duties;
- Special knowledge or experience;
- Individual ability;
- Previous training;
- Compensation paid in prior years;
- Prevailing economic conditions;
- Living conditions in a particular locality; and
- The type of activities carried out by the organization and its size.

Internal Revenue Manual 4.76.3.11.5 (4-1-03). These are the salient factors in determining comparability; not whether the employer is a nonprofit organization or not. State courts, too, have followed this approach. *See, e.g., Gateway Rehabilitation Ctr, Inc. v. Board of Comm'rs of the Cnty. of Beaver*, 710 A.2d 1239, 1244-45 (Pa. Commw. Ct. 1998).

The sources above constitute clear legal authority. In the absence of any statute, regulation, case law or even articulated administrative policy in Oregon, GICW appropriately and prudently relied on the available legal authority.

In contrast, the sole source that the Department cites for the proposition that nonprofit organizations should not rely on for-profit compensation comparability data is the *Dollars and Sense* publication cited above. First, that publication is not legal authority, but rather sets out the personal views of two consultants. Second, even that publication states unequivocally that nonprofit organizations should pay their executives market-based compensation:

The chief executive is a nonprofit's single most important employee. ***Failure to pay a market-based salary, however noble the motivation for doing so, can cause a nonprofit to lose a strong chief executive or find it almost impossible to recruit an effective one, harming the organization's success and its ability to fulfill its mission.***

* * *

Board members should therefore consider very carefully the potential costs of underpaying their organization's chief executive. For organizations that can afford them and are prepared to justify them, ***market-based salaries and innovative compensation practices can help recruit and retain skilled and experienced leaders.*** For organizations that are facing budget constraints, it may make sense to economize in other areas rather than risk the loss of an effective organizational leader. Of course, each nonprofit must decide for itself what mix of compensation features makes the most sense for its individual circumstances.

Dollars and Sense at xii (emphasis added).

The Report also points to a letter from the American Bar Association Section of Taxation, to the Senate Finance Committee dated Sept. 15, 2004, but fails to note that the letter states:

The Regulations to Section 4958 currently allow nonprofit employers to look both to the nonprofit and for-profit sectors for comparability data. *We believe that banning the use of for-profit comparables would harm the nonprofit sector by making it much more difficult for those nonprofits that compete with for-profit employers for qualified employees to attract “the best and the brightest” employees.* We also think it would be inappropriate and excessive to limit the authority and discretion of the nonprofit organization’s governing body in reviewing comparables when setting compensation.

Letter from the American Bar Association Section of Taxation to the Senate Finance Committee, Sept. 15, 2004 at 2 (emphasis added.).

Further, the Report does not refer on this point to the most current and authoritative policy statement available with respect to the use of for-profit comparables. As the Report notes, the U.S. Senate Finance Committee, chaired by Senator Charles Grassley, has been undertaking a review of the nonprofit sector generally in anticipation of proposing federal legislation on a number of issues. In connection with that review, the Senate Finance Committee requested the Independent Sector, a charitable organization that represents broadly the nonprofit sector in America, to convene a panel on the nonprofit sector,” to consider and recommend actions that will strengthen good governance, ethical conduct and effective practice of public charities and private foundations.” Letter from Senators Charles Grassley and Max Baucus to Diana Aviv, President and CEO, Independent Sector, Sept. 22, 2004. To that end, Independent Sector convened a distinguished panel (the “Panel”) comprised of 24 representatives from leading nonprofit organizations nationwide, and convened advisory groups of dozens of nationally recognized experts on nonprofit governance, legal, accounting and financial issues to assist the Panel in its deliberations. The Panel’s intensive review of key issues affecting the nonprofit sector, conducted with substantial input from the work groups and an opportunity for public comment by interested persons nationwide, resulted in a Final Report by the Panel issued in June, 2005, available at www.nonprofitpanel.org. The Final Report represents by far the most thorough and comprehensive thinking currently available on the issues addressed and is expected to form the basis for federal legislative proposals in the area.

The Panel’s recommendation with respect to the use of for-profit comparables is as follows:

The current market based standard for determining reasonable compensation affirmed in federal tax laws provides charitable organizations the necessary flexibility to attract and retain qualified leadership. *The Panel does not believe that Congress or the IRS should require charitable organizations to determine the compensation of key executives only or primarily on comparable positions within the charitable sector.* The Panel also does not believe that Congress or the IRS should limit the compensation of executives of charitable organizations to an arbitrary amount related to government employment contracts.

Charitable organizations increasingly find it necessary to compete with for-profit and government employers to attract and retain a range

of qualified professionals. Charitable organizations are generally not in a position to offer all of the benefits available to corporate executives, nor are they able to offer the job protection and benefits available to many government employees. Governing boards should be free to make decisions about the appropriateness of using comparable positions from either government or the for-profit sector to develop a reasonable compensation package in order to attract appropriately qualified managers.

Panel on the Nonprofit Sector Final Report at 69-70 (emphasis added).

D. Appropriateness of Compensation

1. Overview

The Report's conclusion regarding GICW's executive compensation is based not on any legal authority, but on an apparent belief that (1) senior executives at nonprofit organizations should be paid less than senior executives at comparable for-profit organizations; and (2) senior executives at nonprofit social service organizations such as GICW should be paid less than senior executives at nonprofit international relief organizations, grantmaking foundations, universities and hospitals.

The idea that executives at nonprofit organizations should expect to accept less than their counterparts in the for-profit sector for comparable services is a philosophical point of view. It is not the law, however, and, as federal courts, the U.S. Congress, and the Panel on the Nonprofit Sector have concluded, it ignores the realities of the marketplace.

The idea that executives at social service organizations should be paid less than their colleagues at other types of nonprofits similarly reflects a philosophical point of view. The Report acknowledges that more than 150 Oregon nonprofits pay their executives more than \$100,000. The Report then discounts that fact with the statement that most of the individuals receiving this high level of compensation "worked for universities, hospital healthcare systems, major foundations or international relief organizations." All of these types of organizations are of course nonprofit organizations, and GICW is aware that executive compensation paid by some such organizations exceeds \$1 million. The Report offers no basis for its suggestion that it may be permissible for one type of nonprofit organization, such as a grant making foundation (which has no analogue in the for-profit sector), to pay higher compensation than a direct social service provider such as GICW because of the nature of its activities.

The essential point is that an organization should look to the best available data, and the data from the most comparable organizations in terms of size, services, and types of positions, to determine the reasonableness of compensation. GICW has an annual payroll, including benefits, of over \$40 million, and currently more than 1,800 employees, making it one of the largest providers of social services in the state.

For some types of nonprofit organizations, there may be no comparable organizations or positions in the for-profit sector, and the best data available may be exclusively from the nonprofit sector. In other areas, however, many comparable employers will likely be for-profit organizations. In some situations there may be insufficient comparables in the nonprofit sector to enable a nonprofit's board to make a decision consistent with its fiduciary duties. Similarly, in some contexts there is a single labor market in which both for-profits and nonprofits must compete for the same individuals. In these situations a nonprofit organization's board not only should, but arguably

must look to comparables in the for-profit sector in order to fulfill its fiduciary obligations. That is not to say that it is necessary or desirable to look exclusively to for-profit comparability data – but rather that it is necessary in some contexts to include for-profit data (along with any comparable nonprofit data) in order to make the best determination.

2. Compensation Analysis

GICW engaged an independent, highly regarded compensation consulting firm to advise GICW with respect to the reasonableness of historic compensation of GICW’s president, and to assist in crafting a compensation package for GICW’s president for the future. The Department did not have the benefit of such professional expertise in its compensation analysis. As a consequence, the Department’s Report is flawed in its presentation of technical compensation analysis and fundamental compensation principles, and is inconsistent with best practices recommended by executive compensation experts.

The Report asserts that the first criterion in identifying comparable organizations for establishing compensation should be mission. This criterion is not reflected in the well-developed list of factors under federal tax law and does not reflect established compensation management practices. The approach used by today’s leading compensation practitioners is to consider the employer’s business strategy, the skills required to execute that strategy, the market for those skills, and “scope metrics” (*i.e.*, revenue, number of employees, size and operating budget). Mission does not determine comparability for purposes of compensation analysis. A grass-roots community organization with no employees and a budget of \$20,000, and a multi-state social services provider with a budget of \$50 million may have the same mission, *e.g.*, to alleviate poverty, but the duties, skills, time commitment and responsibilities of the CEOs of the two organizations, and consequently their appropriate levels of compensation, will be vastly different.

Market factors, experience and performance, job complexity, and organizational values or strategies are significant elements in determining appropriate compensation. GICW believes that its labor market for qualified top executives is tied to the nature of the model that it employs to create employment opportunities for disabled and disadvantaged individuals. As described above, GICW is a leader in the social entrepreneurship movement. GICW achieves its mission through employing the disabled and disadvantaged in its retail operations and other activities. It is economically self-sustaining and does not rely to any significant degree on government funding. The labor pool of executive talent capable of effectively executing this model is limited, and the range of entities competing to retain that talent includes both for-profit and nonprofit organizations.

GICW’s historic emphasis on performance-based bonuses is also consistent with the recommendations of compensation professionals. The greater the portion of total compensation that is linked to performance, the greater the extent to which the executive has compensation “at risk” and has an incentive to work to achieve organizational goals. The Department has not cited any legal authority, and GICW is not aware of any, that prohibits Oregon nonprofit organizations from employing substantial performance-based compensation components to motivate their executives.

IV. LOOKING TO THE FUTURE

GICW believes that the procedure for a nonprofit organization’s review and approval of executive compensation should be independent and transparent, and that the compensation package that results from the process should constitute no more than reasonable compensation that is fair to the executive. The level of executive compensation must allow the organization to attract and

maintain the best available leadership, and at the same time should be consistent with the organization's mission. Because mission, is, after all, the reason that GICW exists.

GICW believes that the Department shares these goals. GICW's past procedures regarding executive compensation have been fully consistent with applicable law. GICW recognizes, however, there is always the opportunity to achieve a higher standard. GICW's fundamental philosophy is to strive for continuous quality improvement. Just as GICW is at the forefront of serving its mission of providing vocational opportunities to people with barriers to employment, GICW recognizes that it has the opportunity to be at the forefront in exploring and adopting emerging practices and policies regarding nonprofit executive compensation. For this reason, GICW has worked with the Department in crafting a Compensation Committee Charter and Total Compensation Philosophy that may serve as models for other Oregon nonprofits. We look forward to continuing to work collaboratively with the Department to develop best practices for establishing nonprofit executive compensation.