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## FINANCIAL FOCUS



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## Your Accounting for a New Economy

# Increased Scrutiny for Not-For-Profit Compensation

Not-For-Profit organizations usually fall into one of two categories. Either they're a small charity with annual gross revenues of less than \$25,000 and employing people who volunteer their time for little more than a 'thank you'; or they're a much larger organization necessitating full-time employees and a considerable payroll. Now with the IRS threatening increased examination, organizations that fall into the latter category may want to review their compensation-setting process to ensure they are in compliance with best practices.

The public has often viewed the salaries paid to high level executives of well-know charities with a certain degree of skepticism, a skepticism that has only grown over the last few years with news of other businesses, both public and private, increasing salaries and bonuses despite receiving federal bailout money. While in reality, one issue has little, if anything, to do with the other, it's a distinction that many fail to see, and in response to the public's request for oversight, the IRS has increased the scrutiny applied to the compensation packages paid by not-for-profit organizations.

- March 2007 – As a result of the Executive Compensation Initiative Project, the IRS announced that it had levied \$21 million in excise tax assessments which it called intermediate sanctions.
- December 2007 – The IRS rolled out the revised version of Form 990 which required a much more detailed and comprehensive description of the processes not-for-profit organizations use to determine compensation levels.
- February 2009 – The IRS released its exempt organizations hospital study which discusses compensation practices at tax-exempt hospitals.

◦“Although many of the compensation amounts reported may appear high to some, nearly all examined amounts were upheld as established pursuant to the rebuttable presumption process and within the range of reasonable compensation.” (pg. 4)

◦“The area of executive compensation poses similar challenges. Amounts reported appear high but also appear supported under current law. For some, there may be a disconnect between what, as members of the public, they might consider reasonable, and what is permitted under the tax law.” (pg. 4)

◦“The IRS will continue its enforcement work in this area through examinations and other compliance initiatives. As part of this work, the IRS will seek a better understanding of the impact of certain aspects of existing law, including the permitted use of for profit comparables, and the rule excepting the initial contract between the organization and the executive.” (pg. 4-5)

In today’s current climate of economic sensitivity it’s even more important that not-for-profit boards and executives fully understand the rules governing compensation and maintain detailed documentation of the decision-making process to ensure they are adhering to the best practices.

Failure to comply with the IRS’ best practices for determining compensation could result in stiff penalties or even the loss of the organization’s tax exempt status. If you have any questions about your organization’s responsibilities when it comes to compensation best practices do not hesitate to contact Neely Duncan, Not-For-Profit manager at (214) 461-1437 or by email at [nduncan@lgt-cpa.com](mailto:nduncan@lgt-cpa.com).

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