Compensating Foundation Directors?
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February 20, 2008

Should a foundation compensate members of its board of directors for their service? It's a perennial question in the field of philanthropy. But it sprang into the public spotlight five years ago, when a *Boston Globe* investigative series detailed abuses of American foundations at the hands of those entrusted with their management. *The Globe*'s Exhibit A was the small Boston philanthropy whose chief trustee paid himself over $5 million from 1998 through 2002--including $1.4 million in 2001 alone, to cover the costs of his daughter's wedding. Other appalling cases from around the country may have lent themselves to the impression that the already-wealthy were further enriching themselves by taking exorbitant trustee fees from their own philanthropies.

On the heels of these highly publicized abuses, it was no surprise to see the staff of the Senate Finance Committee, then chaired by Senator Charles Grassley, bruiting about the idea of banning or dramatically limiting compensation for foundation board service. Although the Panel on the Nonprofit Sector, convened by Independent Sector at the request of the Senate Finance Committee, didn't call for an outright ban, in its "Principles for Good Governance" issued in October 2007, it did suggest that "board members are generally expected to serve without compensation, other than reimbursement for expenses incurred to fulfill their board duties."

As suggested in Adam Meyerson's message explaining The Philanthropy Roundtable's refusal to sign on to the recommendations, there is in fact no such "general expectation" in the world of foundations about board compensation. To begin with, the practice is entirely legal. While board members fall under the Internal Revenue Code's prohibition of "self-dealing," an exception is made for "payment of compensation . . . for personal services," which includes fees for board members. Payments, however, must be "reasonable and necessary to carry out the exempt purposes" of the foundation, and "not excessive."

Board Compensation, by the Numbers

Although it's hard to come by reliable data, it's safe to say that compensated board service is by no means rare. Indeed, at the height of the furor created by the *Boston Globe* series, long-time foundation critic Pablo Eisenberg and several colleagues at Georgetown University published a study of board compensation showing that it's quite common. Using a relatively small sample of 1999 IRS filings (from 176 of the largest private foundations and 62 small foundations), they concluded that 64 percent of the former and 79 percent of that latter compensated their boards.

A more thorough survey--*Foundation Expenses and Compensation*, a series prepared jointly by the Urban Institute, the Foundation Center, and GuideStar and based on a survey of tax filings from 2001 through 2003 of the 10,000 largest foundations of all sorts--found that 20 percent of independent foundations compensated trustees. The median compensation for that period was $8,000 per year, while the average compensation was $15,700. In an earlier survey, the researchers found that roughly four-fifths of compensated independent foundation trustees received less than $25,000, while only 1 percent received over $100,000.

A considerably smaller sample drawn by the Council on Foundations from its membership indicated that, in 2004, over 58 percent of independent foundations compensated some or all of their board members--a figure that went up to over 83 percent for foundations with a corpus greater than $500 million. Median compensation for this group was $15,000, with the mean over $19,000.

The Association of Small Foundations' 2007 survey of its membership, consisting of small-staffed or volunteer-run philanthropies, found that 31 percent compensate for board service, including 23 percent of its family foundations and 43 percent of non-family foundations. Of foundations with more than $50 million in assets, 45 percent provided compensation. In this category, median annual fees were $20,000, with an average fee of over $21,000.

Statistics like these are important benchmarks for foundations thinking about compensating board members. Recourse to them will help insure that compensation is in fact "reasonable," understood as "the amount paid similar persons for similar work at similar organizations." That formulation comes from a guide prepared by the Association, "Trustee Compensation for Small Foundations," which helpfully outlines six steps to meet the IRS's standard of reasonableness:

1. Board members should remind themselves of their "fiduciary duty to act in the best interest of the foundation" when discussing their own compensation, and even consider appointing outside advisors to determine the appropriate amount.

2. The board should specify the work expected of and performed by its members, including number of meetings, complexity of work, hours worked per week, and expected experience and qualifications.

3. Based on this information, the foundation should look at compensation surveys like those from the Council on Foundations, the Association of Small Foundations, and regional grantmaking associations to determine what "other foundations with a similar asset size pay for similar work."

4. The board should hold a formal vote to establish the compensation level, preferably by unanimity, bearing in mind that the IRS will consider "reasonable" a level in the mid- to lower-range of the data compared with peers.

5. The board should do a "reality check" on itself before going public, double-checking the total percentage of assets that will now go to trustees as opposed to grantees, and recalling that the compensation information will be readily available to the public.

6. Board minutes should record the amount of compensation, summary of the discussion and vote, the data used to make a decision, and the date of approval.

Similar advice can be found in guides prepared by the Council on Foundations and the National Center for Family Philanthropy. None of these organizations simply oppose board compensation. Instead, they all recommend that foundations should compensate their boards with the utmost concern for both the legal requirements and public appearances. For instance, the Council on Foundations notes that its board "is firmly opposed to excessive or unreasonable compensation. Even the public perception of excessive compensation can be damaging to the whole field of philanthropy."

To Pay or Not to Pay?

Supporters of board compensation tend to believe that it's not enough to rely simply on the altruistic call of civic or moral duty to induce individuals to serve on boards, and that some financial consideration may be appropriate as well. Modest compensation, they argue, is essential to attract prominent, professionally credentialed individuals who possess the level of sophistication required to oversee the work of foundations, some of which are highly complicated organizations with technical programs spanning a great variety of social problems.

"The larger and more complex the private foundation becomes, the more time that is demanded of trustees, the more likely that directors will be compensated," notes Eugene Tempel, director of the Center on Philanthropy at Indiana University. John Healy, formerly president of The Atlantic Philanthropies, once remarked, "we pay our trustees, and we pay them quite handsomely....We're asking busy people who have other careers, sometimes in very specialized fields, to give us a lot of time."

These individuals can expect generous compensation for service on for-profit boards, the argument goes, so foundation compensation is essential to remain competitive. Joel Fleishman, Duke University scholar of American philanthropy, noted in 2001 that potential trustees "are in demand in the [for-profit] private sector....You need to be able to have a large pool. Everybody's got a limited amount of time."

At a minimum, paying a board member essentially establishes a contractual obligation on the part of a busy and otherwise distracted individual to continue to devote time and attention to the work of the foundation. "If the relationship between two people is an economic one," Healy argues, "the purchaser of the service has a right to demand a level of quality that doesn't exist if it's a purely voluntary relationship."

Furthermore, payment of fees reduces the temptation for board members to "take advantage of board service for personal gain," write Ellen Bryson and Andrew Schulz in their 2003 summary of compensation pros and cons prepared for *Foundation News & Commentary*. An unpaid board member might be inclined to reward himself indirectly or covertly by trying to redirect the foundation's grantmaking toward projects reflecting his personal goals or relationships. (One way for uncompensated boards to counteract that temptation is to earmark modest sums for discretionary grants by individual board members.)

Other observers have pointed out that compensation can lend itself to greater diversity among board members. Bryson and Schulz, for instance, note that some foundations believe that board compensation allows them to "recruit a diverse board," by "opening service up to individuals from different cultures, classes, ages, or personal situations who might not otherwise be able to serve as volunteers." Similarly, in her study "Trustee Compensation: What's Appropriate?" Alice Buhl finds that younger members of family foundations "are not always wealthy," and may be starting out life as teachers, social workers, or nonprofit employees who have to take vacation time to meet the demands of board service. "Serving on the family foundation board may impose real personal financial challenges in the absence of trustee compensation."

Finally, there's the issue of risk. Given the increased level of Congressional and legal interest in the affairs of foundations, some argue, it may be necessary to make it worthwhile for prominent individuals to run the risk of being subjected to embarrassing public investigations--and perhaps even legal penalties. Ironically, board compensation in this formulation is both part of the problem and part of the solution.

Opponents of compensation for foundation boards tend to take as their point of comparison not private corporations, but rather nonprofit organizations. Among nonprofits and community foundations, the almost universal practice by board members is not only uncompensated service, but financial contributions from--not to--trustees.

Voluntary service, in this view, is regarded as an essential expression of human devotion to purposes beyond self-interest and a moral obligation of American citizenship. Philanthropy consultant Lee Draper argues in *Foundation News & Commentary* that "serving without compensation encourages board members to discover the deepest values of philanthropy," which are "about altruism, the subordination of self-interest for public benefit." By this standard, foundation board compensation is not only a questionable practice, it's tantamount to a betrayal of the moral foundation of American civil society. The late Waldemar Nielsen, a prominent foundation observer, maintained that compensation "represents a deplorable perversion of the idea of voluntary service."

Such critics believe that foundations that pay their own trustees--while expecting board members of their nonprofit grantees to serve without compensation--stand guilty of hypocrisy and double standards. "I can't imagine any nonprofit submitting a grant proposal to a foundation and saying 'we're going to use part of the grant to pay our trustees,' and the foundation not saying, 'Then, you're not getting the grant,'" says Rick Cohen, former executive director of the National Committee for Responsive Philanthropy. "Foundations are generally averse to supporting that kind of behavior on the nonprofit side, so why do they do it themselves?" Virginia Esposito, president of the National Center for Family Philanthropy, notes that many of her members think to themselves: "I would be appalled if a nonprofit that I was thinking to fund paid their trustees, so we should not either."

Critics are certainly right that resources devoted to board compensation are not going to grantmaking. Pablo Eisenberg maintains that "it's downright shameful that some foundations are taking money that could be used to make desperately needed charitable grants and are instead just giving that money to their own wealthy trustees." In his study of foundation trustee fees, for instance, he notes that the 238 foundations in his study paid almost $45 million in board fees in 1998. "To add insult to injury," he continues, "many foundations then count board compensation against their minimum payout requirement."

Some foundation observers dismiss out of hand the notion that compensation is essential for a foundation to attract to its service the high caliber of board members it seeks. William White, president of the Charles Stewart Mott Foundation, insists that "we have never had to pay our board members. There are many, many excellent potential candidates who would love an opportunity to serve on a foundation board free of charge. We do not need to pay them for their charitable contributions." Colburn Wilbur, formerly president of the David and Lucille Packard Foundation, similarly defended Packard's preference for voluntary service: "Universities, hospitals, and even the largest nonprofits seldom pay trustees, why should the Packard Foundation?"

At any rate, critics of compensation argue, there is no concrete evidence that compensated boards are any more effective than voluntary ones. Kirke Wilson, president of the Rosenberg Foundation, maintains that "to my knowledge, there is no research supporting the notion that trustee compensation results in higher levels of engagement, better grantmaking, or better work."

Since Wilson's comment appeared in an interview with the *Stanford Social Innovation Review*, the Center for Effective Philanthropy has in fact tried to study this question of the relative effectiveness of compensated vs. uncompensated boards. Center president Phil Buchanan points out that its studies found that paid trustees do in fact "spend more time on board matters outside of board meetings and generally are more involved in a host of ways--setting the agenda, participating in meetings, going on site visits, and reading more of the board materials. They are also clearer on their roles." But, he cautions, "we don't know if the compensation causes these differences and, even if it does, it's surely fair to suggest that there are likely other ways to motivate those behaviors." Furthermore, he adds, "trustees' ratings of the board's mix of skills and experiences or the board's overall effectiveness didn't vary between boards where all members are compensated and those where none are."

To the idea that compensation is necessary to secure service from lower-income individuals, critics point out that a reasonable alternative is to reimburse board members fully for any direct costs of service, a practice that is more common--and much less controversial--than trustee fees. And as for family members who claim they cannot serve on their family foundations without significant compensation, it should perhaps be taken as a signal that they don't take an otherwise compelling family obligation sufficiently seriously, and are not likely to be dedicated and active board participants.

But compensation also introduces some tricky questions of organizational dynamics into foundation boards, with the potential to complicate the relationship between the staff and the board. Alice Buhl, for example, suggests that compensated board members may "feel they need to justify their compensation by spending time for the foundation on tasks that might be better done by staff." That is to say, they could fall prey to the temptation to act as de facto program officers, plunging into the details of grantmaking and sidetracking an otherwise coherent and focused program. Or, as Susan Clark has observed, if a foundation president manages to convey to board members that he is chiefly responsible for securing their annual fees, "they are less likely to rise above the CEO's interest to promote the best interest of the organization." The worry is that they will simply rubberstamp the president's program without attention to fiduciary responsibility.

Self-interest, Rightly Understood

Thus there is a healthy range of beliefs and practices when it comes to compensating members of foundation boards. There are persuasive arguments for and against it, based on corporate and nonprofit comparisons, human psychology, and civic and moral expectations. The current state of the law--permitting compensation so long as it is reasonable, necessary, and not excessive--recognizes and sustains a diversity of approaches, permitting foundations to investigate and emulate the behavior of comparable institutions, while searching for the practice that best suits their needs.

Independent Sector, by contrast, seeks to suppress this experimentation and variety by imposing a "one-size-fits-all" approach to board fees, promoting general subscription to the single standard that "board members are generally expected to serve without compensation."

This may seem to be the nobler path, embracing the view of board service as entirely altruistic, embracing the view of nonprofits as untrammeled expressions of the public interest and the moral good. But foundations, nonprofits, and most other institutions of civil society were never intended simply and purely to reflect or inculcate self-abnegating altruism. Like all American political and cultural institutions, they are complex, invigorating mixtures of self-interest and personal ambition with high civic and moral purpose.

Some Americans do indeed serve without pay as nonprofit board members for reasons that transcend the self. But others serve because it reflects and fulfills more particular needs of the self, as devoted partisans of their own families, friends, and local communities. This hospital saved my father's life; this university provided the education that allowed my daughter to blossom; this youth center saved my grandson from a life of crime; this community foundation supports the park down the street where my children play. All of these reasons for joining boards are as much expressions of self-interest as of abstract moral principle.

There's nothing wrong with this form of motivation. Indeed, Alexis de Tocqueville recognized it as the essential principle of American civic life. In the democratic age, he argued, civic life had to find new motivations for the great public undertakings that had once been the noble, magnanimous, and self-transcending gestures of the aristocracy. That new impetus was to be found in "self-interest properly understood," which would lead American citizens to see that their own personal welfare was tied to citizenly engagement with and concern for others, thus fueling the rise of our vast array of voluntary associations.

To embrace uncompensated board service as the sole permissible standard--to insist, in essence, that altruism is the sole motive to which foundations may appeal--is to rule out of order one of the most durable and abiding motives for citizenly engagement in American civic life. If payment of reasonable board fees is necessary to add the inducement of self-interest to moral obligation for some to undertake board service, there's nothing in the American civic creed to suggest that this is unethical or illegitimate. Consequently, it's probably best to abide with the current state of affairs, building civic life and encouraging service on foundation boards by calling upon the full range of human motivations, from self-interest properly understood to self-interest overcome in the name of a transcendent moral purpose.

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