Fall 2007

Implications for Policy Making: A Case Study of Executive Compensation at Nonprofit Organizations in New York State

Amanda M. Spellicy
Binghamton University--SUNY

Implications for Policy Making: A Case Study of Executive Compensation at Nonprofit Organizations in New York State

BY

AMANDA M. SPELLICY

BA, Binghamton University, State University of New York, 1999

CAPSTONE PROJECT

Submitted in partial fulfillment of the requirements for the degree of Masters in Public Administration in the College of Community and Public Affairs
Binghamton University
State University of New York
2007

Accepted in partial fulfillment of the requirements for
the degree of Masters in Public Administration
in the Graduate School of
Binghamton University
State University of New York
2007

David Campbell ____
Assistant Professor
Department of Public Administration
December 6, 2007

Nadia Rubaii-Barrett ____
Assistant Professor
Department of Pubic Administration
December 6, 2007

Zelda Ferguson ____
Legislative Correspondent
Office of United States Senator Charles E. Schumer Washington DC
December 6, 2007

Executive Summary
Implications for Policy Making: A Case Study of Executive Compensation at Nonprofit Organizations in New York State

Problem Overview/Background

Nonprofit organizations in today society face distinct challenges to their viability. Currently they are facing a legitimacy crisis which is a result of four main factors: focus of media on scandals, the aftermath of September 11th attacks, congressional attention and a decline in public trust. The last decade has witness increased media coverage of scandals and instances of impropriety at nonprofit organizations. The coverage by main stream media outlets has resulted in a literate public attuned to poor behaviors at nonprofit organizations. The attacks of September 11th touched all aspects of American life. As a result, the various sectors comprising its society were compelled to respond to the needs in the wake of these attacks. The nonprofit sector was no exception, and they raised unparallel donations to assist victims of this tragedy (Salamon, 2002). In turn, organizations were faulted for their inefficiencies at disseminating donations. As organizations fell under scrutiny other practices such as governance, and executive compensation came under fire. As is often the case, when substantial attention and public outcry is directed at a societal problem lawmakers are compelled to respond. In the case of executive compensation and other practices of nonprofit organizations, the Senate Finance Committee began to hold hearings to investigate these practices and assess various policy options to help remedy the problem.

The events discussed above have culminated in a decline of public confidence in nonprofit organizations. Academic literature focused on the nonprofit sector considers public confidence to be the foundation with which the sector is built upon, and recognizes it has begun to crack (Salamon, 2002; Schlesigner, Mitchell & Gray, 2004). In the aftermath of 9/11, confidence levels were tracked and in the immediate declined significantly. Most troubling is that these levels remained stagnate (Indepedant Sector, 2002; Light, 2003). Trust impacts a variety of elements critical to organization sustainability; including donation levels, volunteer recruitment, and agency morale (light, 2003).

Highlights of Academic Literature

To elucidate the problem three bodies of academic literature were consulted. While consensus exits that organizations ought to be held accountability, there is little agreement about the best manner to do so, what mechanisms ought to be employed and who are the stakeholders that have a vested interest in organizations' operations (Brody, 2002; Hoefer, 2000; Lee, 2004). In looking at the problem of executive compensation it is important to acknowledge that how a societal issue is understood and defined will shape the policy options advanced (Salamon, 1999a; Stephenson & Chaves, 2006; Jacobs & Sobieraj, 2007). Reactions to compensation paid to organizations' executives underscores the disconnect between public understanding of nonprofits and the operation realities of these organizations. Romanticized notions of organizations which are staffed by volunteers with have no concern with monetary compensation is outmoded (Carson, 2002; Salamon, 1999b; Schlesinger et al., 2004). Literature focusing on compensation in nonprofit organizations underscores the significance compensation plays in the success of nonprofits. Compensation is critical for the recruitment and retention of talent to move an organization towards its mission attainment. However, the literature offers minimal guidance for determining compensation and measuring the reasonability of salaries paid (Pynes, 1997; Carroll, Hughes & Luksetich, 2005; Oster, 1998).

The Study

The Project's Scope and Focus

The project is intended to serve as an advisement tool to United States Senator Charles Schumer (D-NY). Given the Senator's interest in impacts to his home state, the project focuses on organizations in New York State, and seeks to answer what are the implications of New York State nonprofit executive compensation for policy making. A sample of organizations from New York City and Broome County was randomly selected and data from its IRS 990 forms were extrapolated for executive compensation, total budget, assets at the end of the year, number of employees, and number of employees paid over $50,000.

Analysis Approach

In order to analyize the data, standards of measure were required. Given the absence of direction in academic literature, a standard advanced by Senator Grassley was utilized and expanded. The suggestion that the President of the United State's salary of $400,000 be a ceiling for compensation of executive directors of nonprofit organizations (Sanders, 2007) was extended to include the highest paid elected executive in each geographic region. New York City organizations were also compared against the mayor's compensation of $194,000 (New York City, 2004) and in Broome County the County Executive's salary of $88,397 (Binghamton Press and Sun Bulletin) was used.

For an additional point of reference, the mean household income for New York State, Broome County and New York City was obtained from the Census Bureau and compared against the mean compensation for the sample, Broome County and New York City respectively. Lastly, statistical analysis was performed to determine the existence of any causal relationship between executive compensation, and total expenditures, assets, employment size and number of employees paid over $50,000 against executive compensation.

Findings

The findings of this project provide illumination regarding the conditions of executive compensation at nonprofit organizations of various sizes, located in areas with varying demographics with differing expenditures. Based on the data analysis it is apparent that problematic compensation may not be as systemic as perceived. Overall, compensation rates at New York State nonprofit organizations did not appear to be exorbitant or unreasonable based on the standards of measure applied. Four major findings emerged from the analyses performed.

- **Incomplete Information.** 30% of organizations selected were missing critical data on their IRS Form 990 or did not have one on file and were consequently removed from the sample. This rate of incomplete information is congruous to the findings of a larger project *The Exempt Organizations Executive Compensation Compliance Project* conducted by the Internal Revenue Service (Strom, 2007b) .
- **In most cases, the compensation of executive directors does not exceed the highest paid elected official**. One organization exceed the President of the United States, eight New York City organizations paid their executives more than the Mayor, and six organizations' executive compensation in Broome County

exceeded the County Executive.

- **Most executives pay exceeds the average household income**. The figure produced by the United States Census Bureau is considers employment of all types held by those with a variety of educational backgrounds and work experience. Executive director positions typically have educational and work experience requirements that will elevate salaries.
- **Executive Compensation determination does not seem to be arbitrary.** Executive compensation appears to be influenced by other factors at an organization including an organization's budget, assets, total number of employees, and type of organization (cultural or human service). The effect each variable has upon executive compensation could not be determined given how closely related the variables are.

Recommendations

- **Continue efforts to clarify reporting requirements and tools.** The findings of this project and the IRS' *The Exempt Organizations Executive Compensation Compliance Project* demonstrate that there are problems with the existing Form 990. A draft version is has been released and will be deployed for tax year 2008 (Strom, 2007b). The efforts of this IRS study must be replicated to gauge the effectiveness of said changes, and the results must be well publicized.
- **Evaluate and study effectiveness of current oversight body.** The present agency, the IRS is a collection agency with a primary goal of securing revenue. Assessment must be conducted regarding the effectiveness of this current system and determinations made about its future role in the oversight of philanthropy

(Lang, 2005). A feasibility study and cost benefit analysis ought to be conducted to evaluate if the creation of a new agency dedicated to the oversight, regulation and promotion of nonprofit organizations would improve conditions.

- **Nationalize accreditation of charities.** Given the problem of public perception it is imperative that a uniform nationalized seal of approval designation be created and a program to award it implemented. To ensure the legitimacy of the accreditation, standards must be developed with nonprofit sector input and it must be a uniform nationwide award. To be prudent this must not be implemented until a determination of future oversight agency is made. At that time this process can either be housed under that agency or outsourced to a private organization.
- **Improve pubic perception.** As the federal government works to improve conditions for nonprofit organizations to operate in, the sector must also embark upon an effort to improve pubic sentiment and understanding toward its organizations and their operations. This can be accomplished through the provision of information regarding operations and finances directly or indirectly, and the utilization of media outlets to provide substantive reports on good practices and performances of organizations. This collaborative effort between sectors is essential to maximize success.

Dedication

The author would like to conclude her tenure in the Public Administration Program where she began: with a deep appreciation and gratitude to two incredible public servants who have inspired her quest to serve the public, and instilled a deep love of country and passion for civic duty. This project is dedicated to Vincent Pasquale and Charles Schumer, whose careers have been an inspiration.

Acknowledgements

The author would also like to thank those who have played a pivotal role in the completion of her degree, and this project. Without the patience, support, and guidance of these individuals her success would not be possible. To the Binghamton University Masters of Public Administration faculty, especially Professors David Campbell and Nadia Rubaii-Barrett, thank you for your wisdom, insight and mentoring.

To my family, particularly my husband and daughter, you weathered my wrath as I completed this project. Thank you for your support. Without your patience, love, and sacrifice this degree would not be possible.

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Introduction

The terrorist attacks of September 11, 2001 are an unprecedented horror in American history that has left an indelible mark on every facet of American life.
In the aftermath, government responded with the creation of a new agency, overhaul of existing security practices and the implementation of a host of new policies to better ensure the safety of its citizenry. The nonprofit sector's answer was to raise unparalleled donations to address the needs that arose following this horrific event; and in turn faced scrutiny over its performance. Charities response to September 11th illustrates both the strengths and weaknesses of the sector (Salamon, 2002) and has become a benchmark for comparison and evaluation of public confidence in the nonprofit sector, as evidenced by the extensive focus in the literature on the assessment of nonprofit organizations' performance and the impact September 11th has had on the public's perception of the sector.

Prior to September 11th, the public held a generally high level of trust in charitable organizations, but in the months immediately following the terrorist attacks, this sentiment wavered. The Center for Public Service and the Independent Sector tracked confidence levels in charities, and detected a decline in confidence in the aftermath of the attacks (Independent Sector, 2002; Light, 2003). More recent data from the Center for Public Service indicates that confidence in the sector has remained stagnate and not rebounded to pre- September 11 levels (Light, 2003).

Public trust is the very foundation upon which the entire sector is built (Salamon, 2002). Public confidence affects donors' willingness to give time and money, as seen in the case of the United Way, after its highly publicized scandal. The number of donors to this national organization have declined over a four year period from a high of 17.6 million in 2000 to a low of 13.6 million in 2004 (Day, 2006). The foundation of public trust has begun to crack (Salamon, 2002), and consequently, charitable organizations are facing a "crisis of legitimacy" (p.673) that poses a threat to sector sustainability (Schlesigner, Mitchell & Gray, 2004). Public confidence also effects agency morale and helps shape the regulatory and political environments that govern organizations (Light, 2003).

Problem Statement

In a complex and constantly changing societal landscape, thousands of issues and problems compete for the attention of public officials. Many factors play a hand in an issue's transition to agenda status and successful capture of policymakers' attention. In the case of nonprofit organizations' compensation rates, the terrorist attacks and increased publicizing of nonprofit organization scandals have increased the demand for policy action. These factors have accelerated the movement of the issue forward toward policy formulation (Anderson, 2003).

The result, has been vigorous debate regarding nonprofit sector legitimacy, which can be traced to a disconnect between widely held public ideals and the operational realities of what constitute charitable organizations (Carson, 2002). The heightened focus by mainstream media outlets of scandals involving nonprofits, including incidences of seemingly high executive director compensation, at many high profile charities, coupled with Congressional attention to issues of organizational impropriety and misconduct have intensified the debate.

Scandalous behaviors of charities were being reported even before the events of

September 11, 2001. In the early 1990's, then United Way of America President William Aramony was the subject of intense scandal regarding his compensation package and usage of organization funds to pay for travel and living expenses. Aramony was ultimately convicted of multiple felonies including fraud, money laundering and filing of fraudulent tax returns (Kearns, 1994). Cultural institutions have not been exempt from this focus either. A report on the compensation of Glenn Lowry Executive Director of the Museum of Modern Art raised questions about his compensation of $1.28 million in fiscal year 2005. Most troubling was the revelation that a separate tax exempt trust, created by the museum's trustees, paid Lowry $5.35 million on top of reported compensation, over an eight year span. This practice is considered unorthodox, a violation of the intention of tax exempt status and drew scrutiny from the state's Attorney General (Strom, 2007a).

In the wake of the terrorist attacks the performance of national charities, like the American Red Cross, was extensively scrutinized and its dissemination of relief funds faulted. As a result, the Red Cross became a subject of a Senate investigation regarding its management and operational practices including its compensation structure. Media reports chastised the $780,000 severance package of ousted leader, Marsha Evans and decried the more generous package of near $2 million her predecessor Bernadine Healy received in 2001 (Salmon, 2006). The case of The Nature Conservancy exemplifies the influence of the media upon Congress' agenda. In the aftermath of an investigative series, run by the *Washington Post* in 2003 regarding questionable practices at that organization the Senate Finance Committee announced it would examine the sale of preserved land to trustees to build homes along with other governance issues within the organization

(Stephens, 2003).

In the current Congress, political leadership has shifted. Sen. Max Baucus (D-MT), the new chairman of the Senate Finance Committee originally indicated he may back away from this issue. However in light of the findings of the Internal Revenue Services' *The Exempt Organizations Executive Compensation Compliance Project* he has pledged to pursue abuses within the sector (Evans, 2007). The interest of the committee chairman coupled with the continued quest of Senator Grassley (R-IA) for nonprofit sector reform, recent incidences involving compensation at charities and findings from the above referenced IRS studies indicate that the issue of executive compensation is not likely to disappear from the policy agenda.

In 2004, as a response to the intense media scrutiny, public outcry and Congressional investigations, the Internal Revenue Service launched the largest audit of nonprofit organizations in its history (Light, 2005). The findings from *The Exempt Organizations Executive Compensation Compliance* project were released in March 2007. A review of IRS Form 990s, a main reporting tool for oversight of nonprofit organizations was conducted. Over 1,800 tax- exempt organizations' Form 990s were reviewed for their executive compensation data. Of the 50 organizations reporting salaries exceeding $250,000 none initially filed required documenting detailing compensation paid to its employees (Bzdega, 2007). A third of the 1800 organizations reviewed had flawed tax forms, and needed to file amended tax forms (Light, 2005). Additionally, the agency levied $20 million in excise taxes on charities it deemed had paid its executives excessively (Strom, 2007b). Based upon these findings, the Internal Revenue Service recommended additional work in the field of nonprofit compensation including training for agency personnel in changes to Form 990 and increases in the abilities of employees to identify issues with compensation. The findings have been interpreted by Senator Grassley (R-IA), as an indication that the IRS must refocus its priorities to compensation and other matters of nonprofit oversight (Bzdega, 2007).

The compensation practices and excessive expenditures by the Smithsonian Institution particularly in relation to its former Secretary Lawrence Small have generated scrutiny by mainstream media outlets like *The Washington Post*, and *The New York Times* as well as aggressive Congressional action (Eisenberg, 2007). With 70 percent of its budget from Congress, the House and Senate have tight control of the Smithsonian's purse strings. In advance of Secretary Small's resignation an amendment introduced by Sen. Grassley and unanimously supported by the Senate took a bold stance on executive compensation and offered unprecedented guidelines for executive compensation and associated practices. The legislation froze the budget for the museum complex contingent upon reform to compensation practices. Specifically, the legislation suggested that the compensation of the President of the United States serve as a basis of comparison, and nonprofit executive salaries and deferred compensations should not exceed it. At the time, Small's compensation was nearly double. Travel expenditures must be reformed to model existing guidelines for government employees, and Smithsonian employees must adhere to ethical guidelines already in place. In addition, the Senate Rules Committee conducted hearings on the subject of executive compensation and expenses practices at the Institution (Sanders, 2007).

Whether these incidents, highlighted in Congressional hearings and media reports, are indicative of the entire sector, or simply isolated cases, the exposure de-legitimizes the sector as a whole. Organizations already challenged to meet the needs of their constituencies who struggle with budget constraints and other obstacles must also contend with the scrutiny their salary expenditures may face (Carson, 2002). Senator Grassley (R-IA), has played a key role in the focusing of Congress on the service delivery of nonprofits and how they operate their organizations. His concerns with the transparency of operations and accountability of organizations motivated a call for increased oversight of charities by the Internal Revenue Service. As the main regulatory body governing tax exempt organizations, Sen. Grassley (R-IA) urged for a re-examination of the existing regulations and expressed a desire for more information to enable Congress to make judgments as to whether executives are being too much. The release of the *Exempt Organizations Executive Compensation Compliance Project* findings has been used by Grassley as justification the IRS must refocus its priorities to the oversight of executive compensation (Bzdega, 2007).

The response of the Senate, with respect to the Smithsonian Institution's funding is notable. Its actions dictated an assumption of "reasonable compensation" absent a comparability assessment (Sanders, 2007), the standard applied by the IRS for reasonable compensation as "the value that would ordinarily be paid for like services by like enterprises under the circumstances" (Bzdega, 2007, np). Questions remain as to whether this is an indication of future approaches to charitable organizations, compensation practices including the imposition of a salary cap for nonprofits or if this was an isolated response to a particularly egregious abuse (Sanders, 2007).

The reports by the media have exposed many instances of questionable practices by nonprofit organizations, and the intense reaction by Congress has furthered the notion that conditions within the sector are serious. The question is whether these reports of abuse of public dollars and trust are indicative of a systemic problem within the nonprofit sector or isolated instances of specific organizations. On face, due in large to the attention scandals have garnered, it appears that the sector is plagued with corruption and engaging in practices of exorbitant executive compensation, improper allocation of resources towards superfluous expenditures like salaries and benefits rather than directed towards programs.

Policy makers contemplating regulatory action face constraints and must evaluate the tradeoffs of any course of action chosen. Additionally, information regarding executive compensation practices throughout the sector will provide those tasked with policy formulation a better understanding of what the average organization does in this regard. However, even armed with this type of information, the sheer size and diversity of the sector makes it very difficult to adopt "a one size fits all" approach to the oversight of compensation and other practices. Lawmakers must grapple with issues regarding appropriate determinations for allocation of agencies' resources, including the differences of opinion with regard to what the sector is and what compensation in the nonprofit sector ought to look like.

Research Question

What are the implications of executive compensation practices in New York State for policy making at the federal level?

Conceptual Framework

Executive compensation rates for nonprofit organizations may impact the perceived legitimacy of organizations in the eyes of elected officials, the public, donors, and other stakeholders. This is significant for consideration as legitimacy and public trust present serious challenges to nonprofit sector sustainability and viability (Salamon, 2002; et. al, 2004). To underscore the challenges faced by nonprofit organizations in today's environment in setting executive compensation rates, and defending its choices, it is helpful to place this issue in the context of nonprofit sector accountability, and a review of who nonprofit stakeholders are. An understanding of how nonprofit sector accountability has become a perceived policy problem requires discussion regarding how the policy process functions, and considerations that impact policy formulation.

An overview of these bodies of academic literature provides valuable insight into the problem and is intended to serve an informative role to the target audience of this project: the policymaker. How the problem has been perceived and defined, along with understandings about the nonprofit sector and its accountability all influence and shape the courses of action proposed and debated at the policy level. While the wide range of nonprofit organization makes it difficult to apply one universal understanding, definition or policy to govern them all, it is essential to provide this framework to assist lawmakers in making informed decisions about what the role of government in the oversight and regulation of the nonprofit sector ought to be.

Literature Review

The literature on nonprofit sector accountability provides some key information identifying the stakeholders to whom charitable organizations are beholden and what stake these entities have in the operations of organizations. It also reveals that there are myriad interpretations and applications of accountability. As the issue of executive compensation paid by nonprofit organizations has traversed through the theoretical policy process, it has been shaped, influenced and defined by a variety of factors. How it is understood today has driven the debate over policy formulation. The manner in which compensation of nonprofit executives has become a policy issue, and how it has been understood and defined has impacted the response of elected officials and the attention of media. The literature on nonprofit compensation issues is not nearly as dense as the other bodies of literature reviewed and is deficient of clear guidelines for evaluating and determining rates of pay. However, it is clear that compensation plays an important role in the operations of charitable organizations, and the sector continues to implement and test new approaches to remain competitive.

Accountability

Organizations must respond to a host of demands and strive to meet expectations set by a variety of individuals and groups. The term “accountability” is complex and encompasses a variety of different interpretations. Brody (2002) classifies the term into three sections and poses three questions: asking to whom, in what way and how the nonprofit sector is accountable, in order to provide some guidance to understanding the term accountability. Attempts to answer them however, also underscores how subjective the term is and the difficulties in reaching a universal understanding. Using these classifications, this section offers an overview of accountability literature and provides information to answers these questions.

What is nonprofit sector accountability?

An extensive body of literature exists regarding the importance of nonprofit accountability (Hoefer, 2000). Given how broadly the term is applied, less agreement exists regarding how to define it in the context of nonprofit organizations. In the literature, accountability has been applied to a host of various topics including outcome measurement, program evaluation, internal management, ethics, and organizational assessment (Lee, 2004). These applications are illustrative of widespread usage of this term, and are by no means exhaustive.

The concept has generally implied answerability to a particular constituency or stakeholder, and also to reference the "method of legally required information submitted to government regulatory agencies" (Lee, 2004, p. 170). Hoefer (2000) submits that accountability includes "a willingness to endure pubic scrutiny, even invitation for the public to scrutinize the behaviors of the organization's leadership" (p. 167). This interpretation is more rigorous in its demands on an organization, and likely to not be embraced by all organizations. Brody (2002) advances four broad meanings of accountability "financial probity," "good governance," "adherence to donor direction and mission," and "effectiveness and public trust" (p. 475-476).

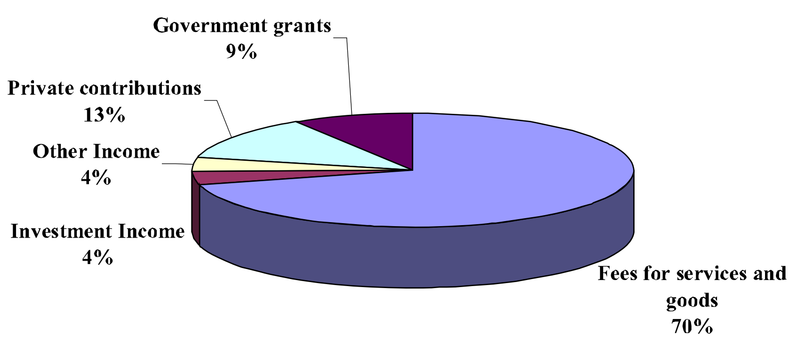
It is unlikely that one universal application of accountability can be developed as the meaning of this term is subjective and based upon the vantage points of various stakeholders. Therefore, what entities the nonprofit sector is deemed accountable to is based in some part upon how that organization is understood. This presents an additional challenge for the sector given the multiple and sometimes conflicting demands which they face from stakeholders (Brody, 2002).

How are nonprofit organizations supported?

"Financial probity" is discussed as a measure for accountability. The term accountability contains within it a root word that "suggests a reckoning for a sum of money" (Brody, 2003, p.475). Therefore in its most simplistic terms, one notion of accountability implies fiscal responsibility. In considering finances as a means to hold organizations accountable, attention ought to be directed at the mix of nonprofit resources and income.

Figure 1:

Revenue Sources for Reporting Public Charities 2004



From "The Nonprofit Sector in Brief Facts and Figures from the "*Nonprofit Almanac*"
National Center for Charitable Statistics at the Urban Institute, 2007.

As Figure 1 illustrates, the major revenue sources for nonprofit organizations are fees with private contributions being the next largest. The provision of resources by an entity to an organization is commonly understood to signify a stake in the organization, and assumes an expectation of accountability to that funder, by the organization. This data can be utilized to determine who stakeholders might be, but it is unclear if the share of revenue corresponds to the degree of accountability these stakeholder are afforded.

To Whom Are They Accountable?

The literature on accountability extensively discusses the notion of stakeholders. There exists some debate regarding what constitutes a stakeholder and a great deal more with regards to a ranking of importance. Commonly discussed groups include, boards of directors, peer charities, donors, organization's staff, elected officials acting in the role of regulator, the constituency the organization serves, and the general public (Brody, 2002).

The role of the public at large as a stakeholder is debatable. Most accountability literature focuses on the obligations that organizations have to direct stakeholders and the notion of financial accountability. Lee (2004), a proponent of the inclusion of the public at large in the field of nonprofit sector stakeholders, finds the current body of literature deficient in evaluating this accountability dynamic. To justify the obligations nonprofits have to the public at large, Lee (2004) cites the privileges and financial benefits the sector receives. These benefits and direct cost subsidies are shouldered by the public at a cost of $165.8 billion annually (Brody & Cordes, 1999). To provide some perspective, this figure is higher then government spending for all veteran and agricultural programs in fiscal year 2002. The acceptance of tax exempt status, and right to seek tax deductible contributions by nonprofit organizations, is viewed by Lee (2004) as a contractual obligation of the organization to its membership and to the public. For these reasons, the public, as taxpayers and citizens ought to be recognized as the largest stakeholder group the nonprofit sector has (Brody, 2002).

Donors are generally accepted as a stakeholder group with associated accountability implications for the charities they fund. However, this group collectively accounts for only 12.5 percent of charities' revenue (National Center for Charitable Statistics at the Urban Institute). If financial contributions alone are to serve as a justification of stakeholder status, then the public has even larger stake in the sector given the large cost of subsidies organizations receive (Brody & Cordes, 1999).

The Policy Process

The story of executive compensation and congressional intervention can be traced through the policy process. This conceptual framework of stages where an issue is transformed into a policy, implemented and evaluated for effectiveness is a widely embraced theoretical understanding of how policies come into being. An extensive body of literature exists regarding the methods of policy making, including a focus on what motivates legislators' interest in public conditions, and prompts them to take on problems. Attention is afforded to the policy process as it provides insight into how the issue of executive compensation has reached its current state.

Problem identification

A societal condition or situation must produce "a needs or dissatisfaction among people and for which relief or redress by governmental action is sought" (Anderson, 2003, p.81). Ideally, a policy problem will impact a large number of individuals with a scope that extends beyond those directly involved in the issue and is difficult for an individual to solve (Anderson, 2003). This assertion holds true for the case of executive compensation, as the impact of abuses is widespread. Most directly it is felt by the donor who elects to make a contribution to the organization, which in 2005 accounted for $260.3 billion (NCCS at Urban Institute). However the scope of impact is much wider when an additional $165.8 billion, in subsidies and benefits, born by the public is considered (Brody & Cordes, 1999).

A challenge in this process and relevant to nonprofit sector executive compensation, is that the definition of a problem is subjective and will be perceived differently by various groups or individuals (Anderson, 2003). The manner in which the problem is defined will dictate the course of action, support, opposition and response from various stakeholder groups including those tasked with regulatory and legislative responsibilities.

In terms of the definition of nonprofit executive compensation, perception and understanding has certainly impacted the manner in which this issue has been viewed. This to some degree is a manifestation of the understanding widely held regarding the nonprofit sector, which Salamon (1999a) finds to be one of the mostly commonly misunderstood aspects of American society. The literature frequently discusses an incongruity between the public understanding of nonprofit organizations and the operational realities of the sector (Carson, 2002; Salamon, 1999b; Schlesinger et al., 2004). The identity crisis and subsequent decline in legitimacy of charities, (and concern over compensation practices) may find its roots in this misunderstanding (Schlesinger et al, 2004).

Confusion regarding the sector is not a new phenomenon. Skepticism over its practices and operations dates back to the time of the ratification of the Constitution of the United States of America. The rhetoric articulated by early Americans regarding the failings of Harvard College, the first American nonprofit corporation is similar to those heard today (Hall, 1987). The evolution of what the sector is has largely been dictated by history and the subsequent demands and constraints placed upon the sector for its survival. An overview of the sector's development is not pertinent to this project. What is significant is that a change in the makeup of the nonprofit sector occurred over time as in response to political and societal conditions as a means to ensure sustainability. Today's nonprofit sector reflects, a response to the conservative political climate and required a reduction of dependency on government as funders (Salamon, 1999b). Interestingly, rather than revert to the romanticized ideals of heavy reliance on donations and contributions (Carson, 2002 & Salamon, 1999b), the sector turned to market ideals and professionalism to subsidize its operations (Salamon, 1999b).

The result is a romanticized, and widely held notion of nonprofit organizations bolstered by classical literature like Tocqueville (1945/1994, Carson, 2002). Charities are commonly believed to be "relatively small, volunteer-driven organizations that largely rely on contributions of money, time and goods from contributors" (Carson, 2002, p. 429). Such an outmoded view of charities is inconsistent with the operational realities of a sector that has dramatically evolved from during the time of Tocqueville. Increasingly problematic is that the nonprofit sector has insufficiently articulated its role in modern society and therefore found itself on the defensive as behaviors revealed through scandal exposés, and congressional investigation, are inconsistent with the mythology promulgated of nonprofit organizations as "small voluntary groups ministering to the needy and down trodden" (Salamon, 1999b, p. 14).

The definition of executive compensation as a policy problem is also likely to be impacted by the ambiguity over the sector's purpose and how best to quantify it. It has become common practice to use a host of terms interchangeably to reference the nonprofit sector. This is a misleading, and in many cases inaccurate depiction of the type of organization referenced (Salamon, 1999a). There is little disagreement in the literature that some members of the sector have failed to meet the expectations that theories explaining their existence have set. The consideration of executive compensation in nonprofit organizations as a policy problem is not entirely inappropriate or without some merit. However, the public's confusion regarding the sector and the ambiguity of its purpose may have influenced how this issue has been handled in the policy process. Salamon (1999a) submits that the flaws of some cannot debase the societal value the sector offers. His assertion that nonprofit organizations are considered a vital component of society, a "convenient and fulfilling way to meet community needs" and a key foundation for a "civil society" (p.18), ought to be considered in future policy discussions.

Agenda setting

Policy problems are numerous and therefore face intense competition to achieve agenda status. Nonprofit executive compensation has held a place at both agendas identified by Anderson (2003): the systemic or the general discussion agenda and the institutional one. Executive director compensation's journey to agenda status is the result of a variety of factors. Media attention, sensational events, and lawmakers, individually and collectively have all played a role in the movement of this concern through the policy process.

In the policy arena some problems and concerns attract the attention of the communications media and "through their reportage either can be converted into agenda items" (p. 90) or if that status has already been attained, coverage will give it more salience (Anderson, 2003). The motivation to provide coverage of a particular issue may range from attempts to sensationalize a story, simply to create news or to provide an informative report. Anderson (2003) asserts that the impetus is irrelevant and the significance lays in the role the act of reporting an issue plays in shaping the public opinion and the policy agenda.

Stephenson and Chaves (2006) have observed the role of media in the public policy agenda setting phase of the policy process, asserting that instances of media coverage and spotlight on a specific occurrence may serve as a "focusing event" (p.346). Unlike Anderson (2003), Stephenson and Chaves (2006) believe that the impetus for and manner in which an event is reported can serve to legitimize a specific understanding of nonprofit sector accountability. Using an analysis of the *The Washington Post's* investigation of The Nature Conservancy as their basis, Stephenson and Chaves (2006) assert the reporter's conception of accountability (in this case to be transparent) and through their writing shape or normalize it for their readership. In this case study, a reductionist narrative utilized by *Post* reporters, to convey their own conception of accountability, provided simple assertions regarding the organization's role and lack of accountability to its stakeholders. Stephenson and Chaves (2006) study of *The Washington Post* reports evidences the influence media can have upon public conceptions, in this instance notions regarding nonprofit sector accountability, which in turn shapes response to executive compensation. Media attention of policy problems can be a positive force, but in the instance of The Nature Conservancy, the arguments advanced by the reports, directly shaped the response of policy makers and while factually accurate may have erroneously depicted reality and framed the issue as a "modern-day fable of good an evil" (Stephenson & Chaves, 2006, p. 364).

Political leaders often function as agenda setters and are motivated by a "desire to promote social change and anxious to gain reputation as a reformer "(Walker, nd, p 431 in Anderson, 2003). Leaders may find motivation in thoughts of "political advantage, the public interest, or their political reputations, may seize upon problems, publicize them and propose solutions" (Anderson, 2003). While the motivations for Senator Grassley's (R-IA) actions cannot truly be known, this notion of an agenda setter is exemplified by his presence at the forefront of discussions of nonprofit reform.

In shaping policy agendas and actions, elected officials may gravitate toward policy narratives where they play a heroic role, in order to preserve their own legitimacy and promote their "jurisdictional authority" (Jacobs and Sobieraj, 2007, p.1). The narrative, as a means of story telling is one of the oldest and most common forms of communication. In their historical review of congressional debate regarding the nonprofit sector Jacobs and Sobieraj (20007) isolate a pattern of two dominant, competing narratives: the "selfless charity" and the "masquerade" (p.1). The first and oldest portrayed charitable organizations in a similar vein to Tocqueville (1945/1994, in Carson, 2002), which may have been a justification for the tax exempt status they received, and relegated elected officials to a supportive role. The emphasis placed the charity as the hero, aiding the impoverished and battling social evils, and was a threat to the legitimacy of politicians and government.

Fear of minimization prompted elected officials to embrace and advance a second narrative where charities used the veil of nonprofit status to promote their own agendas, which were often dangerous to society. In this narrative, a heavy reliance was transferred to the politician whose heroic actions protected the name of the sector for those "real" charities. Jacobs and Sobieraj (2007, p. 2) link the evolution of tax policy regarding nonprofits to how "politicians have been able to identify new categories of "false heroes" in a manner that highlights the masquerade narrative." This narrative became popular in the 1940's and 1950's, when politicians in an attempt to legitimize themselves capitalized on cultural influences. The distrust of labor unions, the "red scare" of communism, and fear of subversive groups enabled the shift of nonprofit organization narrative to the "masquerade." This theory is consistent with the arguments advanced by others in regards to the limited manner in which policymakers define a specific societal problem (Jacobs and Sobjeraj, 2007), and underscores that self serving motivations may impact the perception of an issue.

Policy Formulation

This process is often linked with the adoption of policy, but it is a distinct function and considered part of the "predecision" segment of the process. At this point lawmakers must question what can and should be done to combat a problem. In the case of nonprofit executive compensation, certain considerations must factor into the debate. They include the diverse and complex nature of the sector, the components of compensation and the role it plays in organization operability.

Sector Size. The nonprofit sector is enormous and comprised of organizations of different sizes, missions, and fields. It is difficult to quantify exactly how large the sector is. Data documenting the true number of charitable organizations in the United States is limited and what does exist tends to be incomplete. Salamon's (2002) conservative estimate was 1.2 million formally constituted, public serving 501(c)(3) and 501(c)(4) organizations is based on data from the late 1990's. At the time these organizations had a paid workforce of between 9 and 11 million and utilized another 5.7 million in volunteers (Carson, 2002; Salamon, 1999). The sheer size and diversity of the sector makes it difficult to define and establish a uniformly applicable understanding of charitable organizations. The sector is a widely diverse group, as evidenced by the many sections in United States tax code affording exemption status, and the extensive terminology used to reference nonprofit organizations.

Compensation

The focus of this project is nonprofit executive compensation with the intention of providing insight on the prevalence of abuses. Several considerations exist in the setting of an executive's compensation rate. Organizations are forced to operate in a climate of scrutiny, public mistrust and questions of legitimacy. The setting of compensation rates must satisfy the public and watchdog groups, align with rates paid by cohort charities, remain competitive with the private sector and be in accordance with vague IRS standards. While struggling to satisfy the demands of a variety of groups, charities also must concern themselves with self preservation, and compensation plays a critical role in an organization's ability to attract and retain talent that will lead the organization toward mission attainment and sustainability.

Significant discussion has been afforded in this project, to the notion of accountability and the current "crisis of legitimacy" (et. al., 2004, p. 673), which plagues the nonprofit sector. Nonprofit organizations are challenged to allocate resources between programs, services and administrative costs in a manner which meets public expectation. To do so, organizations battle against an outmoded, commonly held belief that nonprofit organizations rely on unpaid volunteers, and struggle to challenge a false and problematic conception that monetary compensation is irrelevant to professionals in the public sector because ones' commitment to a cause ought to be reward enough (Carson, 2002). The literature on nonprofit sector compensation confirms the expectations that nonprofit executives receive less compensation than their for profit counterparts (Carroll, Hughes & Luksetich, 2005). Organizations that are already challenged to meet the needs of their constituencies, struggle with budget constraints and other obstacles, must also contend with the scrutiny their salary expenditures may face. In some cases, an agency may have to choose between employing highly skilled individuals, and avoiding criticism that may undermine it in the public eye. Either option may hamper its mission attainment.

The practice of salary determination alone presents challenges for nonprofits on many different levels. Multiple considerations from the rates of cohort charities, competition from the private sector, and the guidelines offered by the IRS all factor into salary determination. The choices here are significant as mistakes have serious implications for an organization. Salaries that are not "reasonable" carry with them the potential of IRS sanction. Salaries that are not competitive or attractive may result in deficiencies of leadership talent and cause the organization and its targeted constituency to suffer. Charities have several different tools and guidelines available to help make appropriate compensation determinations.

In terms of setting compensation, the IRS offers minimal guidance, deeming reasonable compensation as "the value that would ordinarily be paid for like services by like enterprises under the circumstances" (Bzdega, 2007, np). This standard presents significant challenges for those who must abide and for law makers grappling with policy decisions regarding further regulatory action. In the case of the Smithsonian Institution, a premier and unrivaled cultural entity in the United States, the Board of Regents has nothing to use as a basis of comparison. What if cohorts of a particular charity under pay their executives due to budgetary constraints or other factors? The existence of pay differentials may also make comparisons across organizations difficult, as “Employees who possess the same job title and responsibilities often perform at different levels of productivity or proficiency, making different contributions to the agency’s mission” (Pynes, 1997, p.164). This may account for variance of pay among executive in the same organizations, or among cohort charities, create difficulties for comparisons, or draw scrutiny for an outlier.

Additionally, it may be difficult to discern an accurate picture of compensation for select organizations. To date, regulations have been murky in terms of clearly defining what must be included in reported compensation, which may lead to inconsistencies in rates from charity to charity (Crain‘s Detroit Business, 2006). To reduce loopholes and improve oversight, the IRS has proposed changes to the Form 990. However, it is questionable what impact these changes will have in providing a more accurate picture of compensation. Data used as a basis of comparison thus far have been mined from the old form, the revised Form 990 will not be in circulation for use until the filing of 2009 returns and the revisions released still have the potential for loopholes (Pfeiffer & Healy, 2007).

Literature available on the features and determination of nonprofit sector executive compensation is rather limited when compared to what is readily available for the private sector (Carroll, Hughes & Luksetich, 2005; Oster, 1998). Charities therefore must also look to the private sector not just as a competitor for talent but also a barometer for compensation setting. However, the application of private sector compensation determination is not easily transferable to the nonprofit sector. Private sector compensation is often established to align the interests of executives with the profit-driven firm owners. The literature suggests a strong correlation between firm size and private sector executive compensation and to a lesser extent, but still significant, firm performance and earnings. The amount of compensation is rarely a concern of the for-profit customer, who primarily focuses on the quality and value of a product (Oster, 1998).

The basis of compensation in the nonprofit sector is less universal given the complexity of the sector and the smaller amount of literature available. Oster (1998) submits that in setting executive compensation, the nonprofit sector "behaves like a somewhat constrained version of the for-profit sector, where the strength of the constraints reflects features of the governance of different types of nonprofits" (p. 207). Wage determination faces constraints from reliance on donors, organizational ideology and for profit labor competition. The sector is unique in that regulators constrain the ability of the firms, subject to their regulations to set executive pay (Joskow, Rose & Shepherd, 1993).

In contrast to the for profit world, the nonprofit sector does not have stockholders as there is no profit distribution and profit maximization is not a goal. Rather, charities tend to focus on mission fulfillment as a means to meet the demands of its many stakeholders. Customers, usually donors and clients tend to be very concerned with compensation, as high salaries are viewed as wasteful, fraudulent and may reduce the demand of service from a charity (Oster, 1998).

However beyond the issue of legitimacy, organizations need to concern themselves with compensation matters given the importance it plays in the success of an organization. Likewise, those tasked with evaluating policy options must be cognizant of the role compensation plays in organizational operations and effectiveness. The recruitment and retention of skilled, qualified personnel to lead the organization and help carry out is mission is critical to an organizations success. The imposition of guidelines to dictate compensation can curtail its ability to remain competitive in the workforce.

The role of compensation in recruitment and retention is well documented. The implementation of Strategic Human Resource Management (STRM) as advocated by Pynes (1997) and others is an important inclusion in organizational culture. Adaptability is critical to ensure organizations remain viable and avoid stagnation. In terms of compensation, the development and maintenance of compensation systems is a key component as it enables charities to recruit, retain and motivate employees, an essential component to meeting organizational goals. The decisions about "pay rates, structures and systems influence the ability of an organization to compete in the marketplace to attract the most qualified and competent applications and to retain it's most talented and productive employees" (p.149). A recent collaborative study by Compasspoint Nonprofit Services and the Eugene and Agnes E. Meyer Foundation provides evidence of the value compensation plays in the retention of executives. Findings reveal that a preponderance of the 2,000 executives surveyed are overwhelmed by the magnitude of duties and demands they face and frustrated by the low compensation levels associated with their positions. Most alarming is that 75 percent of respondents indicated an intention to vacate their positions within the near future (Berkshire, 2006).

Several factors determine compensation, including "expectations and fairness by employees, competition from labor market in terms of wages, the extent of additional benefits afforded to employees, federal and state laws, and the organization's capacity to pay certain rates. In the nonprofit sector, compensation setting has been influenced by both the STRM approach to human resource management (Pynes, 1997), and the integration of for profit approaches into public sector operations (Taylor, 2007). The application of innovative approaches, or alternative pay systems, from both fields to compensation structuring may explain some of the features of salaries at the executive level (Pynes, 1997).

Skill based pay or pay for knowledge, approaches considers the number of tasks and responsibilities a position requires and the knowledge an employee must have to perform effectively in a specific role. The compensation system is "based on paying for what employees can do, and for the knowledge or skills they possess" (p. 165). This is particularly relevant in the case of nonprofit executives. They are hired for the expertise and experience they have and are faced with making difficult decisions that may be in opposition to elected leadership, and other stakeholders and be required to run interference (Pynes, 1997).

The private sector has long embraced performance pay as a feature of executive compensation. Recently, nonprofits have made attempts to integrate this concept into their compensation determination structure as a means to remain competitive (Taylor, 2007). In essence, pay is predicated upon the contributions an individual is able to make to an organization, and not on seniority, equity or need. In the absence of true ownership in a firm or organization, executives may be tempted to shirk duties. Performance based pay has become an available option to reduce the likelihood of responsibility shirking by creating additional motivation (Oster, 1998).

Critiques of this practice raise questions regarding the ability of those making salary determinations to develop workable and meaningful performance standards, and deem the practice essentially subjective. It appears this method of compensation setting may not always be a good fit for charitable organizations, and research supports this approach has not achieved the results and desired effects of increased motivation and effectiveness (Pynes, 1997). For some charities, the logic of structuring performance based incentives may not be as clear cut as in the private sector. The management structure in a nonprofit organization is complex, and may therefore neutralize the effectiveness of pay for performance (Oster, 1998). Additionally, some organizational successes may not be quantifiable, such as in the case of cultural institutions (Taylor, 2007).

The legitimacy of organizations may be questioned by the application of performance based pay. Incentivizing exemplary performance may create appearances of impropriety as a violation of the nondistribution constraint placed upon tax exempt organizations which in turn may impact donations (Oster, 1998). Attempts to link bonuses to fundraising goals may present ethical implications as the solicitation of funds by a director would ultimately be self serving and run the risk of priority dilution (Taylor, 2007).

Despite the skepticism expressed regarding the appropriateness and effectiveness of performance based pay in nonprofits, it cannot be entirely discounted. In the case of large organizations, Carroll et.al (2005) finds performance pay for executives to have positively impacted performance. Of greater significant is the limited empirical evidence of expense preference behavior: compensation increasing at the expense of efficiency, or the decrease of efficiency "with respect to managerial compensation" (p. 40). Additional work must be done with respect to fundraising personnel and their compensation structure. However Carroll et.al (2005) makes a case that this practice should not entirely be dismissed and that in some applications it has a significant impact upon charities operations.

Compensation rates may also affect morale in a less overt manner. Counter to the value that compensation has in retention of employees is the impact executive compensation may have on the morale of others employed within organizations. Ensuring that workers do not perceive that executives are overpaid at the expense of their own salary is a concern many organizations grapple with. In theory, salaries and other compensation paid to top individuals in an organization are public, readily available and therefore can easily be obtained for a basis of comparison. Individuals opting for careers in the public sector accept salaries that in all probability are less than they would command in the private sector. Boards of trustees and others responsible for human resource management issues must consider both implications when setting compensation levels for nonprofit executives (Lipman, 2005a).

Methods

Observations regarding the phenomenon of scandal, media reporting, Congressional attentions, and public sentiments regarding the nonprofit sector's executive compensation practices, have led to questioning the appropriateness of compensation. While it may be difficult to quantify "appropriateness" the core question is whether these instances of excess are representative of the entire sector.

As a member of the Senate Finance Committee, Senator Schumer (D-NY) is tasked with the assessment of practices, including compensation, within the nonprofit sector. This project is intended to be useful to both the Senator and his staff and therefore dictated both the topic selection and geographical focus of this study. The investigation will provide analysis of the conditions within his home state and offer recommendations and findings to provide the Senator with a snapshot of conditions of nonprofit organizations' practices with regards to executive compensation within New York State.

Research Method

A social science research question, like the one proposed in this project, ought to meet the criterion of feasibility, social importance, and scientific relevance (Schutt, 2004). Time constraints have significantly shaped the methods approach utilized in this project. Consistent with Schutt (2004), the development of the research question and methods was done in a manner that acknowledges the time limitations and incorporates a feasible approach to yield the best possible findings. Therefore, existing data were extrapolated from the sample's IRS Form 990s, to eliminate the need to expend time on data collection.

Publicly available data were selected given the difficulties that could be faced while obtaining information from each organization of the sample. Concerns with the bureaucratic obstacles within individual charities to obtain documents also guided the method selection process. Additionally, the researcher's affiliation with a policymaker tasked with evaluating compensation practices, may have influenced the collection of data through other means. There existed a potential for perceived biases by organizations contacted for information and risk of fear generated by questions asked by said researcher. Given the constraints discussed, the data source utilized is the most appropriate.

However pre-existing data does have limitations. Schutt (2004) cautions that one "cannot assume available data is accurate" (p.93), and advises researchers to "be sure to consider carefully whether the original questions are sufficiently close to the measures they need for their new research" (p.94). In the case of 990 forms, misreporting and noncompliance carry punitive consequences for negligent charities. Incentive exists for accuracy. The findings of the IRS' *The Exempt Organizations Executive Compensation Project* illustrate imperfect reporting on this form (Strom, 2007b). At this point, the 990 form is the sole disclosure mechanism for nonprofit organizations and while the study conducted by the IRS illustrates problems it does not suggest that all organizational data contained on this form is inaccurate, or that all organizations are misreporting their information.

A research question in the social sciences must also be evaluated for significant importance to the audience it is intended for. The project's purpose is to provide some illumination for a policymaker regarding nonprofit executive compensation rate setting. In this case, for Senator Schumer (D-NY), it is imperative to provide a sense of the impact any proposed action regarding nonprofit executive compensation will have upon New York State constituents. Therefore, information regarding executive compensation rates within this state and whether the exorbitant salaries reported in media outlets and discussed in Congress are indicative of practices throughout the state are items of interest and significance.

Lastly, the proposed question must be scientifically relevant, or grounded in social science literature. The literature review provides detailed discussion regarding nonprofit accountability, the policy process for this issue and the basis of compensation. Therefore the question selected is well placed in several bodies of academic literature. The approach to analyze the quantitative data is an inductive one, using specific data from an existing source and from that a general explanation to explain the data offered (Schutt, 2004).

Sampling Process

To answer the research question, a sample of organizations, from multiple geographical areas was built. New York State has a diverse population ranging from the largest city in the country to very small rural towns and villages. Therefore, for reliability it was essential the sample be reflective of this diversity and two regions: Broome County in upstate New York, and New York City were selected to provide organizations. The United Way was chosen as a source of human service agencies. In Broome County, the total population of partner agencies was 30, a manageable number; therefore the entire population was selected. For additional prospective, cultural organizations were added to the Broome County sample. The entire population of seven organizations that were affiliated with the Broome County Arts Council, and recipients of the United Cultural Fund Grants was selected.

To build a comparable sample of New York City organizations, the United Way website from this region was consulted. Out of the 202 partner organizations, every seventh agency from the list was selected. To randomly select cultural organizations, the New York City Department of Cultural Affairs website was utilized. Organizations were grouped by boroughs, of which there are five. The seventh organization from each borough's list was selected. To reach a sample of seven, two additional organizations from Manhattan (the most populous borough and lengthiest list) were selected. After the seventh organization was picked, 54 remained. To ensure randomness, the 27th and 54th organizations were selected. Two additional organizations: The Museum of Modern Art (MOMA) and The Nature Conservancy (TNC) were included. Both nonprofit organizations were the subject of media investigation and criticism over their compensation. MOMA is a cultural organization located in New York City, and TNC a conservation organization in Virginia

Data Collection

As previously discussed, data were collected from the IRS Form 990. The most recent 990 filing was selected (mostly for 2006, with the remainder from years 2005 and 2004) and reviewed. For each organization attempts were made to extrapolate data for seven variables from its IRS Form 990. These variables include: executive director compensation (Part V-A or listed as attachment), total number of employees (Line 90b), total number of employees earning over $50,000 (Schedule A, Part 1), total expenditures (Line 17), total liabilities and net assets at end of year (Line 74), location (Broome County or New York City), and type of organization (human service, cultural or other).

Data Analysis

Data was organized into three groups: the entire sample, organizations in Broome County and those located in New York City. For each group, a variety of descriptive statistics were calculated, pairs of variables were correlated for relationships and multiple regressions conducted to further elucidate the effect of relationships. A variety of information regarding organizations can be obtained from an IRS Form 990. The variables used in this project were purposively selected as they were deemed to provide the best picture of an organization's financial picture and a framework for solid analysis of the role executive compensation plays in each case.

Basic descriptive statistics for the mean, median, mode, range, and standard deviation, of executive compensation was determined for each group and compared against a few standards to gauge appropriateness of salaries paid. Regarding nonprofit sector compensation, the literature is sparse often advocating for the adoption of for profit practices and the integration of private sector features. It is devoid of standards for establishing compensation for nonprofit executives and offers no concrete tenets to judge the reasonableness of compensation paid. A review of some of the mainstream media coverage afforded to scandals at nonprofit organizations offers minimal guidance to determine reasonability of salaries at nonprofit organizations. In these instances, concerns advanced over executive salaries in the nonprofit sector seems arbitrary and not pegged to any particular standard of measure.

Sen. Grassley (R-IA), in response to compensation at the Smithsonian Institution advocated, that the salary of the President of the United States, currently $400,000, be used as a cap for public employees' (government and nonprofit) compensation (Sanders, 2007). This standard is the basis for some evaluation of compensation rates at the sample's organizations and utilized as a starting point for their assessment. Since Presidential compensation, was higher than most organizations studied, the researcher expanded the concept of executive level compensation as a measure to the chief executive of each geographical region in the sample. New York City's highest ranking elected executive is its Mayor. Presently, Mayoral compensation is set at $194,000 and was applied to New York City based organizations (New York City, 2004). In Broome County, the highest executive salary paid is to its County Executive at a rate of $88,397 (Binghamton Press and Sun Bulletin). This ceiling was applied to the sample of organizations from Broome County.

In order to better evaluate compensation additional points of reference are required. The researcher created some standards of measure based upon data collected from the United State Census Bureau. The mean household income of residents in a geographical area was selected to provide information about average earnings in that locale. While the mean household income figure is an aggregate total, and compensation a singular salary it does provide a good basis for comparison of salaries in a particular region.

It was important to determine if the variables selected impact nonprofit executive sector compensation. Therefore, correlation functions were performed to test the relationship between total employees, net assets, total expenditures, type of organization, location and executive compensation. This analysis was conducted for each of the three groups (the entire sample, Broome County organizations, and New York City organizations). Correlations' explanatory power is limited, to an investigation of relationships between variable pairs. Upon completion of correlation functions, any variable found to have a significant relationship with executive compensation was included in a multiple regression analysis, to attempt to explain the effect of these relationships.

Findings

Finding 1: Incompleteness of Data

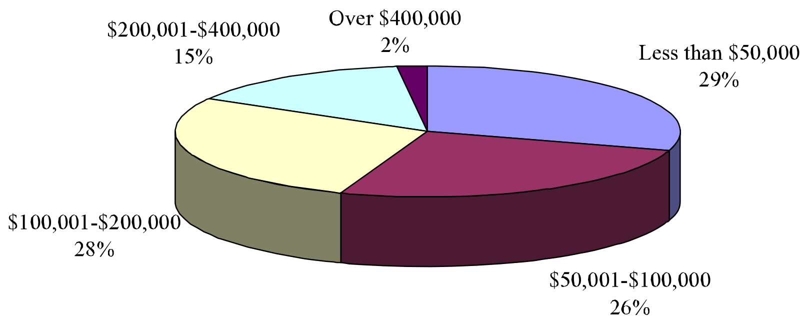
The initial, randomly selected, sample for this project was comprised of 74 organizations. 21 organizations had to be removed from the sample for incompleteness of data or absence of a Form 990. This translates to nearly 30% of the sample, very close to the findings of the IRS' *The Exempt Organizations Executive Compensation Compliance Project*, which found a third of the organizations selected to have flawed reporting forms (Strom, 2007b).

Finding 2: Executive Compensation in Most Cases Does not Exceed Highest Paid Elected Official

Of the entire sample of 54 organizations, one organization reported an executive compensation salary ($1,278,983) that exceeded the salary of the President of the United States. This same organization was the subject of media reports for exorbitant salaries. The breakdown of compensation for the sample is illustrated in Figure 2.

Figure 2:

Distribution of Executive Compensation for Selected Sample

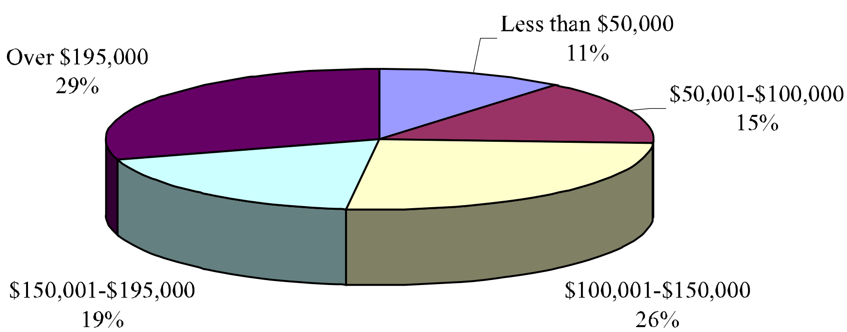


n= 54

As Figure 3 illustrates, eight organizations were found to pay their executives at a rate higher then the City's chief executive, with one of those exceeding the United States' President's compensation threefold.

Figure 3:

Distribution of Executive Compensation for New York City

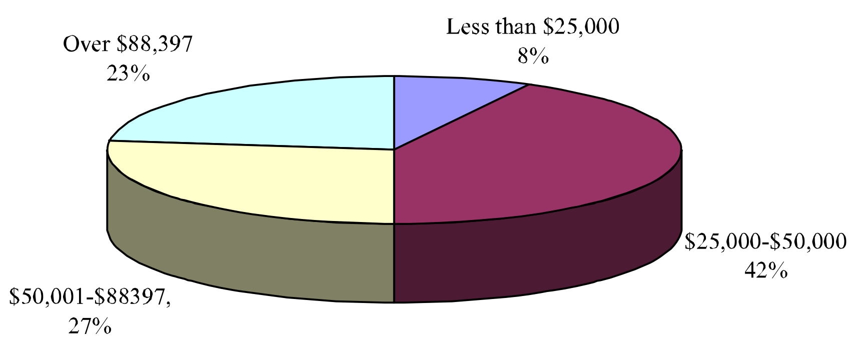


n= 27

In Broome County, six organizations' compensation exceeded that of the County Executive's and none surpassed that of the President of the United States'. Figure 4 illustrates the breakdown by percentage of nonprofit executive compensation within the Broome County area.

Figure 4:

Distribution of Executive Compensation for Broome County



n= 26

A preponderance of the sample's organizations pays their executives at rates equal to or below that of top ranking elected officials. If this concept initiated by Senator Grassley (R-IA) has merit as a measure of reasonability, then most compensation paid by sample organizations can be deemed as such.

Finding 3: Most Executives' Pay Exceeds the Average Household Income.

In each case (statewide, New York City, and Broome County) the mean compensation for an executive is higher than the mean household income for that corresponding region. Census Bureau data incorporates incomes from all types of employment, not just executive positions, and includes working household members with a range of educational backgrounds. It is logical to assume that those employed as executive directors have higher education requirements, work experience and other factors that will elevate salaries. In contrast to household incomes, executive director salaries may appear exorbitant but given the factors mentioned, salaries of executive directors may be explained. It is not enough information to definitive determine if these compensation rates are excessive, but it can be inferred that nonprofit executive directors in each area are compensated at a rate significantly higher than the average individual. Table 1 illustrates this comparison and includes the standard of elected executive compensation for reference.

Table 1: Comparison of Mean Household Income and Executive Compensation

	Mean Household Income	Mean Compensation Paid	Standard for Comparison
Entire Sample	$73,400	$130,100	$400,000 (United States President)
Broome County	$55,000	$61,300	$88,397 (County Exec.)
New York City	$71,100	$188,300	$195,000 (NYC Mayor)

Mean Household Income Data from American FactFinder, 2006, United States Census Bureau.

Finding 4: Executive compensation is impacted by many of the variables

The correlation of variables with executive compensation indicates that significant relationships exist between many. An R value of 1 signifies a perfect relationship. While the analysis did not yield any perfect correlations; it did result in several R values that indicated a substantial relationship with executive compensation, which warranted further investigation. Of the 13 correlations performed, eight yielded R values over .4, a desirable number in proving relationships. The results of the correlations performed suggest that organizations in the sample did not arbitrarily determine the compensation paid to its executive director and there is some causal relationship between an organization's budget, assets it has, and number of employees. Table 2 illustrates the results of the correlations performed between these variables.

Table 2: Correlation of Variables with Executive Compensation

	Tot. Exp	Lib/Net. Asst	Tot. Emp	Type of Org	Location of Org
Entire Sample Exec Comp	.46	.49	.33	.41	.03
Broome County Exec Comp	.65	.49	.49	.28	N/A
NYC and Other Exec Comp	.42	.46	.25	.01	N/A

The results of the regression analyses performed, to determine what effect specific variables had upon executive compensation at nonprofit organizations is illustrated in Table 3.

Table 3: Results of Executive Compensation Multiple Regressions

	R Square	Significance F	Statistically Significant Variables?
Entire Sample Exec. Comp. Regressed with Location, Tot. Expenditures, Liabilities/Net Assets	0.26	0.00	No
Broome County Exec. Comp Regressed with Tot. Expenditures, Liabilities/Net Assets and Location	0.43	0.01	Total Expenditures P Value 0.01
New York City Exec. Comp Regressed with Liabilities/Net Assets and Tot. Expenditures	0.23	0.04	No

In each case, the significance F value is less than alpha, therefore it is can be stated with certainty that the variables explain the variance in executive compensation and it is not due to chance. This is further supported by the R square values for each model that indicate a percentage of the variation in executive compensation (26% for the sample, 43% for Broome County and 23% for New York City) can be attributed to all of the variables. These findings further support the suggestion that executive compensation at these organizations was not arbitrary and influenced by budget size, assets, number of employees, and in some cases location.

The regression analysis also reveals the existence of multicollinearity among the independent variables, given that most of the P values are greater than alpha (.05). The close relationship of the independent variables makes it difficult to discern the effect one has upon executive compensation (dependant variable). This is not surprising given the type of variables selected. The regression model for Broome County organizations indicated a significant relationship between executive compensation and total expenditures illustrated in the regression model for Broome County organizations. The coefficient for this variable is positive and indicates that as an organization's total expenditures increase, so will its executive director compensation: a logical effect which also is not surprising.

Implications for Further Research

Overall, executive directors at nonprofit organizations in New York State have compensation rates that do not exceed the highest elected executive's salary in the corresponding region. They do however, tend to be higher then the average household income of those living in the same geographical area. Before any definitive assumptions about nonprofit sector compensation are made, similar examinations ought to be conducted for other areas of the country. Investigation and discussion of the practices of compensation in other geographical regions of the United States of America is necessary given that the jurisdiction of the Finance Committee and concerns articulated by its members extend beyond New York State.

This project provides a good basis of analyses upon which to build further inquiry. The variables isolated are shown to have a relationship with executive compensation and as a whole an impact on the variation in rates. The variables selected for this project should be incorporated into future study. Perhaps with larger samples the effects of multicollinearity may be reduced and some affect the individual dependant variables have upon executive compensation discerned.

Recommendations

There is little disagreement over the existence of cases of abuse and impropriety within the nonprofit sector. The extent of this behavior and whether ethical standards have eroded are widely debated among practitioners, policy makers, watch dog groups and others. The project sought to answer what the implication of New York State nonprofit executive compensation is for federal policy making. The findings from this project provide illumination regarding the conditions of executive compensation at nonprofit organizations of various sizes, located in areas with varying demographics and with differing expenditures, and assets, as well as problems associated with nonprofit executive sector compensation, and the existing decline in public trust.

The implication of this project is that the perceived problems may not be as widespread as believed and perhaps isolated to large, national organizations typical of those where abuses have been reported. If this project's findings are indicative of the sector as a whole it is reasonable to assert that what is needed with regards to executive compensation is not additional regulation, but rather the implementation of a new plan to manage the nonprofit sector. As a result of the data analysis and upon review of academic literature regarding accountability, the policy process and compensation the researcher offers recommendations for consideration, which are enumerated in the following section.

1. Continue efforts to clarify reporting requirements and tools

Almost thirty percent of the sample had problems with incomplete 990 forms or did not have one filed. Missing or incomplete returns may result from many factors and in this case can only be hypothesized. Organizations may have fallen underneath the $25,000 annual receipts threshold requirement for filing Form 990s; others may not have understood the obligation, misinterpreted portions of the form, or even intentionally chosen to omit data (Strom, 2007b). The similarities in findings between this project and the much larger IRS *The Exempt Organizations Executive Compensation Compliance Project* should not be dismissed. These findings underscore the need to clarify requirements for the tool used (IRS Form 990) for reporting.

This year the IRS released a draft version of a new form, and solicited the input of policymakers, charities and other concerned groups. The scope of reporting requirements was expanded to include more organizations. It is believed to be more user friendly, clearer and also will provide the IRS with more information to enhance its enforcement abilities (Williams, 2007). This is a critical first step, but without proper monitoring or evaluation the changes will be meaningless. The IRS intends to launch this form for the filings for tax year 2008. After one or two cycles of use, the IRS should replicate the efforts of *The Exempt Organizations Executive Compensation Compliance Project* to track the effectiveness of modifications.

Such follow up is necessary and its results must be well publicized, particularly if the compliances rates improve. This project found little instances of excessive compensation and most salaries were similar to the cohort charities of the sample. The concern regarding compensation paid to executive directors may be a function of perception. Hopefully modifications to Form 990 will result in a reduction of reporting errors, and if adequately conveyed to the public may help ameliorate some skepticism. If noncompliance results remain the same, or worsen this too must be articulated along with a plan to further revise the process.

2. Evaluate and Study Effectiveness of Current Oversight Body

Given the 30 percent rate of incompleteness of data, consideration ought to be afforded as to whether the issue lies within the regulations or with the implementation and enforcement of them. Who or what entity is best positioned for oversight of nonprofit organization and whether the proper infrastructure in place at the federal level to do so must be asked. The Internal Revenue Service, which by design is a collection agency, whose goal is to secure, and recover as much revenue as possible, is presently tasked to carry out the regulatory function for charities. For this agency, ensuring charities compliance is an additional duty and not a primary function. They do not exist to support organizations, provide trade-related guidance, education or promote collaboration among charities. Furthermore, the current situation of the nonprofit sector, along with instances of abuses, high profile cases of misconduct and problems with Form 990 reporting, have all occurred on the IRS' watch.

Some members of the Senate Finance Committee, and nonprofit advocacy groups, have advocated for the expansion of the IRS oversight role and increase regulations. Consideration ought to be afforded to the creation of a new regulatory agency tasked solely with the oversight of charities and modeled after existing regulatory entities with a singular focus, like the Food and Drug Administration (Lang, 2005). Debate exits regarding the nature of the sector, whether it is a public or a private entity or a hybrid of both. Precedent exits for governmental agencies to have oversight over private entities as in the case of the United States Securities and Exchange Commission, or in the case of the Government Accounting Office, public entities. The establishment of an agency focused on nonprofits, staffed by those versed in the sector, its challenges, problems and needs would not only create a central organization to review existing regulations for effectiveness, but also implement an infrastructure to reign in abuses and provide a resource for those involved with philanthropy to seek guidance and assistance.

The creation of another agency is likely to be met with concerns over the expansion of the size of government, the cost associated, and expansion of the bureaucracy as well as assertions that nonprofit organizations have built in oversight through their boards, which currently are tasked with the monitoring of financial and ethical practices within an organization (Lipman, 2005c). In light of the anticipated resistance an incremental approach to widespread change is ideal. A study of the effectiveness of current IRS oversight, coupled with a cost benefit analysis of associated expenditures for a new agency contrasted with costs of the current system ought to be commissioned.

3. Nationalize Accreditation of Charities

Compensation for executive directors in New York State charities is relatively reasonable with few instances of exorbitance identified. It seems that most of the study's population is comprised of organizations who are good stewards of public trust and dollars. Yet, what permeate discussions about charities are concerns and assertions of misconduct. The accreditation of charities to certify they are operating ethically and properly may assuage some of the fears and concerns held by the public, while also creating another mechanism for organizations' practices to be reviewed. The notion of a federally funded accreditation effort, under the authority of the Internal Revenue Service, has been discussed within the Senate Finance Committee. The agency would have the option to either operate the accreditation itself or outsource to private entities (Eisenberg, 2004).

Efforts to this effect have already begun, various nonprofit coalitions and advocacy groups have attempted to establish standards and review boards, thereby creating an internal accreditation mechanism (Eisenberg, 2004). Striated efforts for self accreditation dilute the legitimacy and effectiveness of the designation. In order to have an impact, one standardized process must be utilized, ideally by an unbiased entity, absent of any affiliation, to ensure the validity of the accreditation process and legitimacy of the designation. Given the concerns advanced regarding the appropriateness of the IRS in nonprofit sector oversight, it may be prudent to implement this endeavor upon completion of a feasibility study and cost benefit analysis of current systems

Whether this is an appropriate foray for the federal government to take may be contested. While the sector has been defined in many ways, it is widely viewed as a partner to government via its tax exemption and supportive role it plays to bolster the efforts of government and respond to its failings (Lang, 2005). Various changes in the policy environment have disrupted this relationship over the last twenty years but the virtues of government nonprofit collaboration are tremendous (Gronbjerg & Salamon, 2002). Given this relationship, the researcher asserts that it is incumbent upon the government to ensure the viability of its partner and at the same time protect public trust and dollars.

4. Improve Public Perception

The findings of this project illustrate the role perception plays in the problem associated with compensation of executive directors of nonprofit organizations. Given the relationship between government and the nonprofit sector the recommendations advanced thus far advises for the intervention of government, and call upon legislators to make changes in the regulatory structure. The intention is to provide an optimal environment to promote ethical behavior, ensure compliance with regulation and enable charitable organizations to thrive. However, the work to improve the current environment that challenges organization's legitimacy cannot rest solely upon the governmental sector. Therefore, a collaborative effort, between government and nonprofit organizations is necessary to maximize success.

As federal legislators focus efforts to clarify requirements, provide better oversight, evaluate oversight agencies, and implement a federal designation for well performing organizations, the nonprofit sector must do its part to enhance its pubic image and dispel assumptions regarding its practices including how it compensates its executives. This can be accomplished through positive public relations campaigns expansion of media coverage, and dissemination of information.

The sector might consider increased transparency of operations, which may be a direct conflict with the private nature of organization (Eisenberg, 2007), but is a critical component to ensuring the viability of the sector. To do so, Lee (2004) suggests the application of the *Theory of Public Reporting,* explicitly to provide the public with information about recent activities and performances of organizations. Information can be disseminated directly via paid advertisements such as community impact and sustainability reports, and indirectly through main steam and lesser know publications. It is critical that the information be widely circulated with less concern afforded to the complexity of the document.

Additionally, the sector must seek positive journalistic coverage, and strive to implement public relation campaigns to provide the public with better exposure to nonprofit organizations. A representative group ought to be selected to coordinate efforts of this kind. The Independent Sector has played a strong advocacy role on behalf of nonprofit organizations and would be an ideal group to lead the effort. Organizations must advocate to media outlets for coverage of their successes and operations with the same "sophistication" afforded to governmental and private sectors (Egger, 2006, np). Light (2005) advises the sector seek to educate both the public at large and donors regarding the role of administrative costs and the value of investment in organizational infrastructure and personnel. Efforts undertaken by the United Way of America to rebuild confidence in its organization in the aftermath of scandal ought to be replicated and coordinated as a campaign for the entire sector. Under the leadership of the Independent Sector or similar group, this campaign must report the good works of its organizations, publicize the impact its membership has upon society and highlight individual accomplishments of organization employees.

Conclusion

The criticism over the nonprofit sector's performance in the wake of September 11th and intense media coverage of instances of abuse at well know charities worked to create a climate of mistrust and decreased legitimacy towards organizations. Many practices including executive director compensation have been scrutinized and the demand for attention so great as to prompt Congressional involvement. Given the diversity of nonprofit organizations, the size of the sector, and discrepancies in understandings it has been very difficult to determine a course of action to contend with the problems. How to define the sector, and to what societal groups, organizations ought to be beholden are subject to interpretation and impact how the problem is defined. Compensation is an important component to an organization's viability and little has been done thus far to develop workable standards to determine and evaluate such expenditure by a nonprofit organization. Further compounding the problem is the integration of private sector tenets and approaches to compensation practices.

As plentiful as nonprofit sector academic literature is, it is sparse in terms of compensation practices. Little is available to develop an understanding of this practice in the sector or offer guidance in regulating it. The pervading sentiment in mainstream media is that the sector is full of abuses and misconduct. Yet the analysis of sample data for New York State nonprofit organizations finds little evidence of egregious behaviors with regards to compensation. Before conclusive determinations can be made regarding practices nationwide, this study must be replicated in many other areas of the country and with larger samples. Based on the findings of this project and review of academic literature it is evident that the problem is not systemic, rather isolated to select organizations and perhaps the problem is in part one of perception. It is clear that some action must be taken to further reduce instances of wrong doing, and equally important to strengthen the public's trust in the sector.

The debate over the need for regulation and changes in federal law is intense. The logical assumption and perhaps the immediate reaction is the creation of additional regulations through legislation, to further curtail the actions and behaviors of organizations. However it is impossible to legislate against every issue or possible scenario and the reality is that the existence of a law will not entirely curb or deter any behavior, ameliorate the propensity of some for dishonestly, or ensure the education of all affected parties in the requirements of compliance with respect to reporting and disclosure. The creations of new practices to measure performance, oversee conduct and publicize status reports to the public are approaches to consider going forward. The sector is a vital component to society, with a long history rooted in responding to its needs. Effort must be undertaken to ensure it is able to continue its existence.

Appendix A

Human Subjects Approval

Date: October 15, 2007
To: Amanda Spellicy, DPA
From: Anne M. Casella, Administrator Human Subjects Research Review Committee
Subject: Human Subjects Research Approval

Protocol Number: 732-07

Protocol title: Nonprofit Executive Compensation Systemic Problem?

Your project identified above was reviewed by the HSRRC and has received an Exempt approval pursuant to the Department of Health and Human Services (DHHS) regulations, 45 CFR 46.101(b)(4).

An exempt status signifies that you will not be required to submit a Continuing Review application as long as your project involving human subjects remains unchanged. If your project undergoes any changes these changes must be reported to our office prior to implementation.

Any unanticipated problems and/or complaints related to your use of human subjects in this project must be reported, using the form listed below, http://humansubjects.binghamton.edu/Forms/Forms/Adverse%20Event%20Form.rtf and delivered to the Human Subjects Research Review Office within five days. This is required so that the HSRRC can institute or update protective measures for human subjects as may be necessary. In addition, under the University's Assurance with the U.S. Department of Health and Human Services, Binghamton University must report certain events to the federal government. These reportable events include deaths, injuries, adverse reactions or unforeseen risks to human subjects. These reports must be made regardless of the source of funding or exempt status of your project.

University policy requires you to maintain as a part of your records, any documents pertaining to the use of human subjects in your research. This includes any information or materials conveyed to, and received from, the subjects, as well as any executed consent forms, data and analysis results. These records must be maintained for at least six years after project completion or termination. If this is a funded project, you should be aware that these records are subject to inspection and review by authorized representative of the University, State and Federal governments.

Appendix A (cont.)

Please notify this office when you project is complete by completing and forwarding to our office the following form: http://humansubjects.binghamton.edu/Forms/Forms/Protocol%20Closure%20Form.rtf

Upon notification we will close the above referenced file. Any reactivation of the project will require a new application.

This documentation is being provided to you via email. A hard copy will not be mailed unless you request us to do so.

Thank you for your cooperation, I wish you success in your research, and please do not hesitate to contact our office if you have any questions or require further assistance.

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