

## POSITION PAPER: PERCENTAGE-BASED COMPENSATION

**Note: The following information is from a 1992 position paper adopted by the NSFRE, now AFP (American Fundraising Professionals.)**

### SUMMARY

For purposes of this paper:

- Percentage-based compensation for charitable contributions is defined as any compensation that is based on a percentage (sometimes referred to as a commission) of charitable contributions raised.
- A finder's fee is a fee paid for bringing a donor to a not-for-profit organization for the purpose of charitable solicitation.
- A bonus is a form of compensation based on performance (but not on a percentage of charitable contributions raised) that is paid as an incentive to performance in addition to a salary or fee.

The Association of Fundraising Professionals (AFP) believes that individuals serving a charity for compensation must accept the principle that charitable purpose, not self-gain, is paramount. If this principle is violated and percentage-based compensation is accepted:

- charitable mission can become secondary to self-gain;
- donor trust can be unalterably damaged;
- there is incentive for self-dealing to prevail over donors' best interests.

In addition, percentage-based compensation, however administered, can produce reward without merit.

AFP holds that percentage based compensation can encourage abuses, imperils the integrity of the voluntary sector, and undermines the very philanthropic values on which the voluntary sector is based. AFP stands firm with its Standards of Professional Practice which prohibits members from working for percentage-based compensation or accepting finder's fees.

### INTRODUCTION

Charitable organizations are integral to the fabric of society. Their programs and services reach the areas of social need and cultural enrichment that for-profit enterprises cannot address. Charities rely, in part, on voluntary donations to meet their budgets. Donor trust is of paramount importance. To earn and keep that trust, every aspect of charitable activity must be absolutely ethical. Nowhere is ethical behavior more essential, nor by its absence more damaging, than in philanthropic fundraising.

*To be ethical, philanthropic fundraising must be mission-led, institutionally based, volunteer driven and professionally supported in an environment free of improper motive, unreasonable reward or personal inurement.*

### THE CHARITABLE SECTOR

The not-for-profit sector differs from profit-making business in at least four ways.

#### 1. Law and Regulation

Charities must operate as tax-exempt, tax-deductible entities. They are accorded this treatment under law only as long as they fulfill the social mission for which they were established. Charitable purpose requires that all income of a charity be used in the fulfillment and furtherance of the organizational mission. If a charity's income is greater than its expenses, the law requires that the surplus remain with the charity. Surplus cannot be diverted to private benefit.

**Intermediate Sanctions.** (Note: This section applies to those professionals practicing in the U.S.) In 1996, new U.S. federal regulations were passed that impact compensation in nonprofit organizations. Known as "intermediate sanctions," because they provide the IRS with an opportunity to impose penalties other than removal of 501(c) (3) status, the regulations are contained in section 4958 of the Internal Revenue Code. They give the IRS power to impose fines for excessive compensation of nonprofit executives. Intermediate Sanctions guidelines for setting executive compensation to avoid excess benefit include the following:

1. the arrangement must be approved by members of the organization's board or a board-appointed committee, none of whom have a conflict of interest;
2. the board or committee must have obtained and relied upon "appropriate data" as to the comparability of the compensation or fair market value of the consideration; and
3. the board or committee must document the basis for its determination adequately and contemporaneously.

## **2. Governance**

A charity derives its authority from a volunteer governing body, usually called a board of directors or board of trustees. The board is the charity's legal authority; board members are charged by law to hold in trust the assets of the charitable corporation. Board members serve voluntarily and without compensation providing governance, policy development, financial security and stewardship.

## **3. Voluntary Support**

Charitable organizations rely on donations voluntarily given. There is no comparable exchange in the business world. In a commercial transaction, tangible value passes from one party directly to the other for a stated price. In a transaction between a charity and a donor, the value that passes from one to the other is the promise that the service for which the donor implicitly contracted will, in fact, be delivered by the charity.

The service recipient is society, a community or a party unknown (and frequently unidentified) to the donor. The donor's belief that the charity will use the contribution purposefully, effectively and efficiently for the charitable mission is the foundation of the philanthropic exchange.

## **4. Motivation**

The motivating factor in commercial behavior is primarily personal gain. Because commerce is profit-oriented, employee compensation in the form of commission or other percentage income related to output and productivity is appropriate. Workers seek and accept commercial employment in return for personal profit.

The motivating factor in charitable behavior is social benefit. What may be proper motivation in commerce is inappropriate in the not-for-profit sector. There is an inherent conflict of interest between charities founded without intent of profit or private benefit, and employees whose compensation and primary motivation are based on personal financial gain.

## **AFP'S POSITION**

AFP believes that individuals serving a charity for compensation must first accept the principle that charitable purpose, not self-gain, is paramount. It is our view that if, by definition, private financial benefit cannot inure to the charity, it should not inure to the worker.

By law, compensation based on skill, effort and time expended, remunerated by salary or fee, does not constitute personal inurement. Conversely, AFP believes that a commission or percentage based compensation or a finder's fee breaches the no-inurement principle and is, therefore, a violation of its Standards of Professional Practice for six specific reasons.

1. If the self-inurement principle is violated, the mission and long-term interests of the charity may become secondary to the worker's personal interest and self-gain. The donor's (and public's) interest and needs may no longer be foremost.

2. Donor attitudes can be unalterably damaged in reaction to undue pressure and the awareness that a commission will be paid to a fundraiser from his or her gift, thus compromising the trust on which charity relies.
3. Percentage-based compensation or commissions can foster inappropriate conduct by individuals whose self-interest is oriented to immediate results, irrespective of the donor's best interests.
4. Fundraising is an ongoing process of donor identification and cultivation. Individuals develop an affinity for an organizational mission and wish to further it through charitable contributions. A major tenet for success is that an organization is strengthened when volunteers are actively involved in this process. The role of a professional fundraiser should include building an increasingly committed, enthusiastic and capable group of volunteers who affect the fundraising process without compensation. Tying staff compensation to a percentage of charitable contributions raised may discourage this activity.
5. Percentage-based compensation can provide reward without merit. Contributions that materialize at a given moment are often the culmination of the efforts of many people, including volunteers, over long periods of time. The person whose compensation rests on a percentage of charitable contributions raised would wish to include such gifts for the purposes of calculation his/her compensation. For example:
  - a. Charities receive unexpected or unsolicited gifts, often bequests, sometimes from previously unknown benefactors. Such windfall gifts can provide an unrealistically high base--in effect, an unearned base--on which percentage-based compensation may be calculated.
  - b. Promises of payment of contributions in the future, in the form of written pledges, annuity and insurance contracts, and other such financial agreements, can elicit unpaid gift values a fundraiser may expect to be included in the base for his/her compensation calculation.
6. Donors' interests may not remain paramount. There are a variety of charitable giving instruments, including deferred giving arrangements, from which prospective contributors may choose. The fundraiser who compensation is based on a percentage of charitable contributions raised may influence donor choice so as to generate the greatest current result rather than preserve the donor's assets for the best long-term benefit to him or her, and to the charity.

## THE AFP CODE

AFP requires its members to adhere to a Code of Ethical Principles and Standards of Professional Practice that have been developed to preserve and protect donor rights and the integrity of the philanthropic process.

AFP holds that percentage-based compensation and finders fees may encourage abuse, imperil the integrity of the voluntary sector, and undermine the philanthropic values upon which it is based. Accordingly, AFP's Standards of Professional Practice include the following statements:

### Compensation

16. Members shall not accept compensation that is based on a percentage of charitable contributions; nor shall they accept finder's fees.
17. Members may accept performance-based compensation, such as bonuses, provided such bonuses are in accord with prevailing practices within the members' own organizations, and are not based on a percentage of charitable contributions.
18. Members shall not pay finder's fees, or commissions or percentage compensation based on charitable contributions, and shall take care to discourage their organizations from making such payments.