

August 31, 2011

Mr. Sutton Turner  
 Executive Business Pastor  
**Mars Hill Church**  
 1411 NW 50th  
 Seattle, WA 98107

Re: Compensation Review

Dear Mr. Turner:

We were requested to provide a report and comparison of compensation amounts paid to three employees of Mars Hill Church (MHC): Pastors Mark Driscoll, Jamie Munson and Dave Bruskas. In the management structure of Mars Hill Church, we believe all three positions should be considered *disqualified persons* as defined in Internal Revenue Code Section 4958. Amounts in excess of reasonable compensation might be subject to excise taxes, and potentially considered private inurement, risking the church’s tax exemption.

Detailed results of our investigation are included on the attached charts. This letter describes our investigation, summarizes the results, and describes the process by which the Board of Elders may use this report in making a determination of “reasonable compensation.” The letter should be read in conjunction with the details of the supporting materials.

**Executive Summary**

In the body of this report, we provide more detail regarding the appropriate standards and process for setting compensation levels that meet tax exemption requirements. The following items provide an overview and introduction to those materials.

The tax regulations establish a process that substantially enhances the ability of a church to defend the compensation amounts it pays its ministers and executives. It requires that (1) an independent board make a decision on the amount in advance of payment, (2) the board considers compensation paid in comparable situations, and (3) the board records its decision at the same time it makes the decision. Our report provides the information that meets the second requirement, compensation paid in comparable situations.

The collaborative management structure among the Pastors in this study makes comparisons to other churches or organizations a little less certain. The uncertainty is more significant for the Executive Pastor and Network Director, than for the Lead Pastor. We looked at a variety of possible job descriptions to be used in making comparisons. The exhibits have the job descriptions used. The comparisons we used are:

	<b>Church</b>	<b>Non-Church</b>
Pastor Mark Driscoll, Lead Pastor	Senior Pastor	CEO or President
Pastor Jamie Munson, Executive Pastor	Executive Pastor	Vice President of Operations
Pastor Dave Bruskas, Network Director	Blend of Executive Pastor and Associate Pastor	Executive Vice-President

For the Lead Pastor’s compensation, we provided information from several sources, but the critical source we believe is a proprietary survey of other large churches (“Large Church Survey” in the exhibits). These are all churches about which we have substantial knowledge and believe to hold orthodox theology, have active,

creative ministries, and be operated generally with integrity and knowledge of the law. The survey illustrates that compensation of senior pastors has only a little relationship to the size of the church attendance or budget.

	<b>Church Budget</b>	<b>Church Attendance</b>	<b>Senior Pastor's Compensation</b>
<b>1</b>	<b>\$ 30,000,000</b>	<b>13,000</b>	<b>\$ 1,000,000</b>
<b>2</b>	<b>\$ 35,000,000</b>	<b>7,500</b>	<b>\$ 1,100,000</b>
<b>3</b>	<b>\$ 9,000,000</b>	<b>7,500</b>	<b>\$ 429,518</b>
<b>4</b>	<b>\$ 53,700,000</b>	<b>17,000</b>	<b>\$ 330,000</b>
<b>5</b>	<b>\$ 8,800,000</b>	<b>3,316</b>	<b>\$ 325,000</b>
<b>6</b>	<b>\$ 16,700,000</b>	<b>8,500</b>	<b>\$ 275,000</b>
<b>7</b>	<b>\$ 15,000,000</b>	<b>10,000</b>	<b>\$ 265,000</b>

For both the Executive Pastor and Network Pastor, we used several relevant surveys. The National Association of Church Business Administrators (NACBA) collects church compensation data, and we used a filter for churches with annual revenue of \$10 million or more. For non-church organizations, we obtained comparisons for religious organizations in the \$18-38 million range using (a) an ERI calculation based on their entire Form 990 data base and (b) specific organizations in that size range.

Information for the positions of Executive Pastor and Network Director:

	<b>Executive Pastor Comparisons</b>			<b>Network Director Comparisons</b>		
	<b>Executive Pastor</b>	<b>VP-Operations: ERI</b>	<b>VP-Operations \$18-38 Mil. Orgs</b>	<b>Blended: Exec. &amp; Assoc. Pastor</b>	<b>Exec. VP ERI</b>	<b>Exec. VP \$18-38 Mil. Orgs</b>
<b>90th Percentile</b>	\$190,032	232,736	\$208,974	184,186	196,717	\$202,638
<b>75th Percentile</b>	\$178,290	188,372	\$157,190	161,417	160,431	\$169,137
<b>Median</b>	\$139,943	139,645	\$122,172	110,471	120,576	\$136,030

## Report Context

We believe there are two distinctly different, relevant elements for determining compensation in churches and other tax exempt organizations:

1. Reasonable compensation indicates a range of payment for services, based on what similar organizations are paying for similar services. Compensation reports, as we have done, provide information for determining reasonable compensation. Compensation in excess of the high end of reasonable compensation is illegal for exempt organizations.
2. Wisdom factors are attributes of individuals or organizations that relate to how much a person in a position should be paid, which may be less than the maximum reasonable compensation. Factors, such as specific scope of responsibility, longevity, experience or inexperience, training, financial health of the

organization, and compensation philosophy are typical factors considered. Some of the associated data and our comments seek to address some of these factors.

It is often difficult to precisely determine whether a specific payment is “reasonable” or not. The tax law addresses this difficulty by assigning a burden of proof. Ordinarily, an exempt organization is required to prove that the compensation it paid is reasonable—the organization has the burden of proof. If the evidence is vague or ambiguous, because of limited comparable situations, for instance, then the organization may be unable to carry its burden of proof, and may lose.

To encourage advance planning and board level involvement in executive compensation, the tax regulations provide a procedure to shift the burden of proof to the Internal Revenue Service. When this procedure is followed, a rebuttable presumption of reasonableness is created (Regulation Section §53.4958-6). That is, the compensation is deemed reasonable unless the IRS can prove the compensation is unreasonable. With the rebuttable presumption of reasonableness, the IRS faces the challenges of vague or ambiguous evidence from limited comparable situations that previously might have defeated the organization. The IRS may be unable to carry its burden of proof, and may lose.

The regulation has three requirements for creating the rebuttable presumption of reasonableness:

1. A disinterested board or committee must make the decision in advance. “Disinterested” in this sense means they do not have family or business relationships to the person whose compensation is being considered. They could not be employees of the organization. If some board members would not qualify as disinterested, they can be excluded from the consideration of compensation, in order to provide a disinterested decision-making body.
2. The board or committee must make its decision after considering evidence of compensation paid in comparable situations. “Comparable” may include such factors as nature and size of responsibilities, qualifications and experience for position. This report provides the necessary evidence of compensation paid in comparable situations.
3. The decision and basis for the decision is recorded contemporaneously. Generally, this would be recorded in the minutes of the meeting including a record of: (a) the consideration of employee compensation, (b) the evidence presented, and (c) the amount decided upon to be paid.

While there is no specifically required analytical approach to determining reasonable compensation, Regulation Section §53.4958-6(c)(2) provides this guidance for the board:

**(i) In general.**—An authorized body has appropriate data as to comparability if, given the knowledge and expertise of its members, it has information sufficient to determine whether, under the standards set forth in §53.4958-4(b), the compensation arrangement in its entirety is reasonable or the property transfer is at fair market value. In the case of compensation, relevant information includes, but is not limited to, compensation levels paid by similarly situated organizations, both taxable and tax-exempt, for functionally comparable positions; the availability of similar services in the geographic area of the applicable tax-exempt organization; current compensation surveys compiled by independent firms; and actual written offers from similar institutions competing for the services of the disqualified person.

The emphasis of the regulation is on “similarly situated organizations,” with “functionally comparable positions” in “the geographic area” of the exempt organization.

Generally, we believe a church is not quite like any other organization. For all size churches, higher standards of personal behavior and an indefinable spiritual leadership are required. In addition, for larger churches,

similar leadership and management skills are required as for similar sized non-church organizations. Even the size is hard to compare to non-church organizations, because of the substantial use of volunteers.

For these reasons, we believe comparisons to churches tend to be the most similarly situated organizations.

We collected and used the estimated value of volunteers, in order to compare to non-church organizations. In addition, we limited most of our comparisons to self-identified religious organizations. Because of the diversity of activities within Mars Hill Church, we did not further limit the comparisons to specific types of organizations.

Identifying a “functionally comparable position” was somewhat easier for the Lead Pastor, since it is fairly similar to the responsibilities of a senior pastor or CEO among comparable organizations.

The position of Executive Pastor has much in common with the position of Executive Pastor in many churches, making that a reasonable comparison. It has many elements associated with a Vice President of Operations in non-church organizations. Attributes of that position often include: “Collaborates in the planning and formulation of organization policies and practices”, and “Oversees the design, operation, and improvement of the system that creates and delivers the organization's products or services” (excerpted from ERI job description in Exhibits).

The position of Network Director Pastor seems to be specific to Mars Hill Church. In the provided job description, it had elements of both an Executive Pastor and of an Associate Pastor. We provided both of these amounts, as well as a blended amount. It seemed similar to that of an “Executive Vice-President” in non-church organizations. Attributes of that position often include: “Directs, plans, approves, revises, and implements overall corporate growth strategies and personnel activities,” and “Oversees a broad range of activities or functions in the organization” (excerpted from ERI job description in Exhibits).

We believe the reference to the “availability of similar services in the geographic area” of the organizations does not require that only local salaries be used, but does require that when a larger area is used, it be established that the larger area is the relevant potential source of “new hires” for the position.

For this report, we generally believe the entire nation has substantial relevance for two reasons:

1. The higher compensation paid to all these positions reduces the impact of resettlement costs and local cost of living differences.
2. The very high level of skills and specific attributes required reduces the number of potential applicants and would usually result in a national search being made.

**Background and Data Collection**

We were provided with the information we requested concerning Mars Hill Church and the positions. We did not perform an independent investigation of these.

The total ministries associated with Mars Hill Church for this compensation study are large and varied. The organizational data may be summarized as:

	<i>Mars Hill Church</i>		<i>Total</i>
	Mars Hill Church (includes Resurgence, bookstore)	Acts 29	
<b>Weekly Attendance</b>	10,000		10,000
<b>Gross Revenues</b>	21,000,000	\$12,000,000	\$33,000,000
<b>Employees</b>	135	8	143
<b>Volunteer Weekly Hours</b>	13,002		13,002
<b>Est. Annual Value</b>	7,570,646		\$ 7,570,646
	<b>Gross Revenue (including volunteers)</b>		<b>\$ 40,570,646</b>

For this report, we generally use the following definition:

*Compensation* consists of regular salary, bonuses, amounts available for employee’s discretionary use (whether used or not), minister housing allowance, employer contributions to retirement plan, employer expenses of medical or other employee benefits, and any benefits and allowances which are treated as taxable income. It does not include expenses related to the church, which are reimbursed under an accountable reimbursement plan.

Some studies and surveys use other definitions of compensation. For instance, the terms “salary” or “cash compensation” are sometimes used and typically exclude non-taxable employee benefits and retirement plan contributions. Since the regulations under Internal Revenue Code Section 4958 explicitly include employee benefits and retirement plan contributions as subject to excess benefit limitations, we include them in our definition, and tried to consistently use comparison amounts which included these.

When comparisons were made to surveys using other definitions of compensation, we adjusted our definition, to make comparisons as true as possible.

We provided compensation data from four sources:

- A. A proprietary survey of compensation paid to senior pastors of large churches. The results of this survey are shown in exhibit, “Large Church Survey”.
- B. National Association of Church Business Administrators collected compensation data amounts, shown in two exhibits: “NACBA \$10 Mill Selections” shows the selection criteria and attributes of responding churches, while “NACBA \$10 Mill Compensation” shows the amounts paid to Senior Pastors, Executive Pastors and Associate Pastors.
- C. Form 990 compensation data compiled by ERI and processed through a mathematical algorithm to provide compensation amounts at various organizational revenue amounts. This data is shown in an exhibit, “ERI Processed Data.” “Compensation” in this particular compilation does not include retirement or health benefits.

- D. Compensation data from Form 990s filed by organizations in 2008 that self-identified themselves as religion-related and had gross annual revenues between \$18 and \$38 million. The compensation amounts have been adjusted for inflation. This data is summarized in an exhibit, “990 Comparison Statistics,” and tables for each position visually portray the compensation spread among organizations. The actual organizations and data are provided in associated tables.

Data from the NACBA study, ERI computation and Form 990 statistical summary for the positions of Executive Pastor and Network Director are summarized visually in charts: “Executive Pastor Data Summary,” and “Network Director Data Summary.”

### **Use of Data**

In assessing the reasonableness, and appropriate compensation for the three positions, we believe the following approaches are consistent with the regulations.

Compensation survey data is generally presented by showing where responses fall within the total survey response. For instance, lower amounts might fall within the 25<sup>th</sup> percentile of all responses. The 25<sup>th</sup> percentile means that 25% of the responses were lower than that amount. A higher amount might be lower than the 90<sup>th</sup> but higher than the 75<sup>th</sup> percentile. That would mean that at least 10% of the responses were higher, but 75% of the responses were lower than that amount.

Better practice includes reviewing a variety of survey and other data, since no two positions or survey collection processes are identical. By examining multiple sources, a better sense of what the “market” is paying people performing similar services can be obtained.

In using survey data, an organization should consider their employee’s responsibilities, education, training, and experience. An experienced person responsible for a more complex situation in a larger organization would typically be paid the higher amounts represented by the survey. Another person, with apparently the same job description might be paid less, because management considered the person’s responsibilities to be less, or the person was still “growing” into the job.

Generally, a person reasonably qualified for a specific position, who is paid less than the 90<sup>th</sup> percentile of compensation in a survey of comparable organizations, will not be considered to be over compensated legally. Where several surveys are reasonably valid, any one survey would generally be sufficient, even if the amount paid exceeded the 90<sup>th</sup> percentile in some of the surveys. Amounts higher than the 90<sup>th</sup> percentile might be lawful, but would not be supported by a survey that did not show higher percentiles.

Where a smaller survey of specific organizations is used for comparisons, it becomes more important to demonstrate that the specific positions and organizations are in fact comparable. Consequently, we have included more information about the specific churches in our large church survey. Similarly, we have included the information from the various specific organizations and our process for gathering the information.

### Lead Pastor

Compensation comparisons for the Lead Pastor are difficult to make for several reasons. Two seem particularly relevant to Mars Hill Church:

1. There are not many churches with such large and diverse ministry as Mars Hill Church. This is illustrated by the small number of churches with budgets of even half of its annual revenue in the NACBA study.

2. Pastor compensation is not driven primarily by competition, but we believe primarily relates to specific church beliefs regarding compensation standards. This is illustrated by the diversity of compensation paid by the large, often complex churches that participated in our proprietary survey.

For these reasons, the “Large Church Survey” probably should be the focus for assessing the reasonableness of the senior pastor’s salary. Averages and percentiles based on the large church survey data are not particularly useful, because of the small number of participants (though we suggest using them for other positions). The unique perspective each church brings to the issue makes this more an assessment of what a few very highly paid pastors receive and consideration of how similar that situation is to Mars Hill Church.

We were told that the Lead Pastor’s significant involvement with Acts 29 might amount to perhaps 10-15% of his time. Involvement with associated ministries is common in very large churches, but less common among smaller churches. We did not include the economic activity of Acts 29 in assessing the size of comparable Form 990 organizations, but it suggests comparison to larger organizations.

The other compensation data for Senior Pastors and CEO/Presidents provides a perspective on what might commonly be expected for compensation. The diversity of results suggest that the Lead Pastor’s compensation should be re-evaluated regularly. For instance, NACBA data (admittedly for smaller churches) would not support even the current compensation, but the Form 990 data would support a higher compensation amount.

#### Executive Pastor (Vice-President of Operations)

Many churches and other exempt organizations have a position similar to the Executive Pastor. Sometimes, this is formally titled Vice President of Operations. Occasionally in churches, the Executive Pastor has similar responsibilities. The position typically has oversight of some or all of the supporting ministries. As churches grow in size, the need for expertise and experience grows. The presence of similar positions in business environments tends to make compensation more consistent across organizations.

The position has additional complexity in the multi-ministry, multi-site environment of Mars Hill Church, where the financial/business elements of diverse programs are centrally monitored and managed.

We believe three surveys have relevance to this assessment:

- NACBA data for “Executive Pastor”
- Form 990, Vice President of Operations
- ERI processed calculations for Vice President of Operations

As shown on the “Executive Pastor Data Summary,” the Executive Pastor’s current compensation is directly supported by both the Form 990 data and ERI calculation for Vice President of Operations. The smaller size of the churches in the NACBA data directly affects the position of Executive Pastor, limiting its utility.

#### Network Director

As noted above, we did not identify specific comparable job descriptions for the position of Network Director, a relatively unique position in Mars Hill Church. We believe it has sufficient similarities to several listed positions that these positions may be used as comparable situations for compensation assessment.

Specifically, we believe three surveys have relevance to the position of Network Director::

- NACBA data for Associate Pastor/Minister and Executive Pastor
- Form 990, Executive Vice-President and Third Highest Paid
- ERI processed data for Executive Vice-President and Third Highest Paid

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We added a line to the NACBA data averaging the Total Compensation shown for Executive Pastors and Associate Pastors to better reflect our understanding of the position of Network Director.

As shown on the "Network Director Data Summary," the Network Director's current compensation is directly supported by all three surveys.

**Closing**

This report is provided to the board and management of Mars Hill Church for their consideration and decision-making.

Thank you for this opportunity to assist the work and ministry of Mars Hill Church.

Sincerely,

A handwritten signature in cursive script, appearing to read "John S. Butler".

John S. Butler, JD  
Tax Counsel

Enclosures

JSB/alh



## Tables and Exhibits

The following exhibits and tables are part of this report, and contain the underlying data upon which our analysis and opinion are based:

<u>Exhibit</u>	<u>Title</u>	<u>Content</u>
1.	Job Description	Job descriptions as used in ERI and Form 990 data.
<u>Tables</u>		
2.	Large Church Survey	Senior pastor compensation data and general descriptions of their churches.
3.	Executive Pastor Compensation Survey Data	Visual summary of collected data, compared with current compensation.
4.	Network Director Compensation Survey Data	Visual summary of collected data, compared with current compensation.
5.	NACBA Data	Compensation paid by large church participants in the National Association of Church Business Administrators salary survey for Senior Pastors, Executive Pastors and Associate Pastors.
6.	ERI Calculation	Compensation paid by religious Form 990 filing organizations in various ranges, based on calculations using their Form 990 database.
7.	Form 990 Summaries	Compensation paid by religious Form 990 filing organizations with revenue in the \$18-38 million range. The detailed reports for the positions of CEO, Vice President for Operations and Executive Vice President follow the summaries.

# Exhibit 1

## Job Descriptions Used by ERI

Italics indicate attributes considered to have particular applicability to Mars Hill Church.

### CEO

#### Alternate Titles

- Chairman of the Board and CEO; Chief Executive Officer; President

#### Overview

- *Plans, develops, establishes, and oversees interpretation and implementation of policies and objectives of organization in accordance with board directives and corporation charter.*

#### Typical Functions

- *Responsible for the profitability of the entire organization.*
- *Holds position of the top executive and principal organization leader in the organization.*
- This position is distinguished from others in that it is the top ranking executive and, in most cases, is the highest paid executive in the organization.
- *Confers with organization officials to plan business objectives, to develop organizational policies to coordinate functions and operations between divisions and departments, and to establish responsibilities and procedures for attaining objectives.*
- Reviews activity reports and financial statements to determine progress and status in attaining objectives and revises objectives and plans in accordance with current conditions.
- Directs and coordinates formulation of financial programs to provide funding for new or continuing operations to maximize returns on investments, and to increase productivity.
- Plans and develops industrial, labor, and public relations policies designed to improve company's image and relations with customers, employees, stockholders, and public.
- Evaluates performance of executives for compliance with established policies and objectives of firm and contributions in attaining objectives.
- May preside over Board of Directors.
- May serve as chairman of committees, such as management, executive, engineering, and sales.

### Vice President Operations

#### Alternate Titles

- Chief Operating Officer; COO; President and Chief Operating Officer; Top Operations Officer

#### Overview

- *Heads, plans, oversees, and coordinates the entire operation of an organization toward the achievement of established operating objectives.*

#### Typical Functions

- *Collaborates in the planning and formulation of organization policies and practices.*
- *Oversees the design, operation, and improvement of the system that creates and delivers the organization's products or services.*
- Oversees and adjusts organization's processes and operations as necessary to ensure efficient and effective execution of policies and procedures.
- This position is nearly always the second highest paid position in the organization.
- Provides operational guidance in analyzing and appraising the effectiveness of organizational operations.
- Participates in the planning, development, implementation, and evaluation of strategic business and performance goals, short- and long-term objectives, plans, budgets, programs, and policies.
- Evaluates operating results throughout the organization to ensure that organization growth and objectives are being met.
- Guides and leads other members of management.
- Monitors the capital expenditure and asset redeployment activities.

## **Executive Vice President**

### **Alternate Titles**

- EVP; Group Vice President; Senior Vice President; Vice President Executive

### **Overview**

- *Directs, plans, approves, revises, and implements overall corporate growth strategies and personnel activities.*

### **Typical Functions**

- *Oversees a broad range of activities or functions in the organization.*
- *This position is distinguished in that it is responsible for a broad range of activities or functions in the organization.*
- *In larger organizations, Vice President level position(s) may report to the Executive Vice President.*
- *Develops, recommends, evaluates and obtains approval of all major corporate personnel and operational plans and programs.*
- Selects, develops, and motivates necessary management talent.
- Guides the development of innovative compensation and benefit programs and provides cost control of this element.
- Contributes to solutions of major public problems.
- May direct operations and/or administration functions.
- May provide staff support services to operating groups in the areas of operations, distribution, personnel, and corporate office administrative services, and participate as a member of the Executive

Committee in planning and controlling corporate growth and evaluating performance against objectives.