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# Client Alert

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# Limits on Executive Compensation at New York Non-Profit Organizations Take Effect April 1, 2013

## Regulations Cap Executive Pay at $199,000 and Set Requirements for Use of State-Authorized Payments


### Executive Summary

Revised regulations under Executive Order 38 will take effect this Spring that will generally limit the maximum compensation allowed for executives at State-funded organizations.

The Order was signed by Governor Andrew M. Cuomo back in January 2012, with State agencies providing clarifying guidance for implementing the pay-related provisions for covered organizations. In late May, 2012, 13 agencies[1] issued Proposed Rules and, following a comment period, released revised regulations at the end of 2012 that are now scheduled to become effective April 1, 2013.

In brief, the new Order provides:

- ***Limited Use of State-authorized Payments for Compensation Costs***: At least 75% of State-authorized payments (increasing annually by 5% to 85% in 2015) must be used to provide direct care or services, rather than to cover administrative costs such as compensation for employees not providing direct services; and

- ***A $199,000 Annual Compensation Cap***: State-funded administrative executive compensation for a "covered executive" at a "covered provider" cannot exceed $199,000.

The Executive Order does allow for exceptions and/or waivers to the $199,000 compensation cap, but it is the responsibility of the covered provider to demonstrate the rationale for deviations from the cap based upon criteria and guidelines defined in Executive Order 38.


[1]Entities directed to promulgate regulations included, but were not limited to: (1) the Office for People with Developmental Disabilities; (2) the Office of Mental Health; (3) the Office of Alcoholism and Substance Abuse Services; (4) the Office of Children and Family Services; (5) the Office of Temporary and Disability Assistance; (6) the Department of Health; (7) the Office for the Aging; (8) the Division of Criminal Justice Services; and (9) the Office of Victim Services. The following entities also issued regulations: (1) the Department of Corrections and Community Supervision; (2) the Division of Homes and Community Renewal; (3) the Department of Agriculture and Markets; and (4) the Department of State.

## Applicability

***Organizations***

Organizations will be considered "covered providers" if they have received State funds or State-authorized payments to provide program services for at least two years prior to and during the covered reporting period in an amount that is:

- Greater than $500,000 on average annually; and
- Equal to at least 30% of total annual in-state revenue during their most recent reporting period.

In calculating the percentage of in-state revenue, organizations must include:

- NY State Funds;
- State-authorized payments;
- Payments authorized by county and local governments; and
- Revenues derived from and in connection with the organization's activities within the State. This includes revenue from sources outside New York State, if derived from or in connection with activities inside the State. An example would be contributions from out-of-state individuals or entities for in-state activities.

Organizations that receive funding from multiple State sources will be judged based upon the total level of such funding.

The Order also covers subcontractors and agents who would otherwise be considered covered providers, except that they receive their State funds from another covered provider, rather than directly from a government agency.

***Individuals***

Individuals considered "covered executives" subject to the compensation limits include Directors, trustees, managing partners, officers or employees whose salary and benefits cannot be attributed to particular program services (as opposed to administrative duties), such as the executive director or chief executive officer, controller or accounting personal, and public relations personnel.

## Limits on Overall Compensation Costs:<br>The 75% "Direct Care or Services" Requirement

At least 75% of State-authorized payments (increasing annually by 5% to 85% in 2015) must be used to provide direct care or services, rather than administrative costs. Administrative cost includes compensation costs for those not providing direct services. Companies may allocate a share of expenses to administrative costs and to program services, including portions of an employee's time and compensation.

Program services expenses generally include those that are incurred in *direct* connection with the provision of services. It specifically excludes:

- Capital expenses;
- Property rental, mortgage or maintenance expenses (except those used by the covered provider to provide housing to program recipients );
- Taxes or assessments paid to any unit of government; and
- Equipment rental, depreciation and interest expenses.

## The $199,000 Compensation Cap

The Order prohibits covered providers from using State funds or State-authorized funds to provide direct or indirect compensation to a covered executive in excess of $199,000. That figure will be reviewed annually to determine if adjustment is necessary, and may be raised subject to approval by the Director of the Division of the Budget.

Executive compensation is defined broadly to include all forms of cash and noncash payments, including: salary; wages; bonuses; dividends; housing; and certain perquisites and educational benefits. It excludes Social Security, insurance premiums and pension contributions generally provided to non-executive employees. It also excludes compensation to a covered executive for program services outside of his or her managerial or policy making duties (i.e., direct services to the organization). Documentation is required to determine the percentage of the covered employee's time and compensation attributable to direct program services and thus excluded from the cap.

> ***PM&P Observation***: We believe that the cap may have the unintended consequence of *discouraging* economies of scale if organizations are forced to hire two executives to do the job that one very qualified (but too expensive) person could perform, to avoid exceeding the $199,000 pay ceiling.

## Exceptions to $199,000 Cap

Payment above the Order's cap may be permitted if the following requirements are met:

- The excess compensation must come from sources other than State funds or State-authorized payments;
- The covered provider must demonstrate that the level of compensation is below the top 25% in the field, according to a compensation survey recognized by the relevant agency and the Division of the Budget; and
- The executive's compensation must be approved by the covered provider's Board or equivalent (including at least two independent Directors or voting members) after a review of comparability data.

Additionally, contracts or other agreements with covered executives agreed to prior to April 1, 2012 are exempt from the pay cap until the earlier of (i) the end of the initial term of the contract, or (ii) April 1, 2014.

## **Waivers of $199,000 Cap**

Covered providers may apply for waivers no later than 90 calendar days prior to the applicable reporting period, or 90 days before the position is filled for new openings and positions.

Departments may grant a waiver if covered providers demonstrate good cause due based on factors including:

- The nature, size and complexity of the organization's operations;
- Probable effects on program services if a waiver is not granted;
- Efforts to secure a comparable executive at a lower level of compensation;
- The qualifications and experience possessed by or required for the covered executives or position, respectively;
- Comparability of executive compensation to pay levels at similarly situated organizations; and
- The organization's review and approval process for executive compensation.

Decisions on waiver applications will be provided no later than 60 days after submission of the application. Waivers remain in effect for a defined period unless revoked by the agency due to either an increase of more than 5% annually in executive compensation, or upon notice based on additional relevant circumstances.

> ***PM&P Observation***: Demonstrating the comparability of executive compensation to pay levels at similarly situated organizations may require analyses of peer groups and surveys. Identifying, interpreting and using such compensation data in a consistent and meaningful manner is critical. This issue will be especially challenging for very large or specialized organizations that are likely to have few relevant peers. Additionally, special care must be taken in presenting this information to staff at State departments who may not be well-versed in how executive compensation levels are set.

## **Reporting**

Beginning April 1, 2013, covered providers will be required to submit a completed EO 38 Disclosure Form. Additionally, at any time during the term or before executing any contract or agreement, the relevant agency may request covered providers to provide information from the Disclosure Form as well as any other information requested.

## **Penalties**

Covered providers in non-compliance will receive written notification and have 30 calendar days to demonstrate compliance. If they cannot demonstrate compliance, they will have 30 additional calendar days to submit a corrective action plan (CAP) and will have at least six months to correct any violations.

If the covered provider does not correct by the end of that period, the department may modify the CAP, and/or extend the deadline for implementation, or issue a final determination of non-compliance with sanctions.

Sanctions for non-compliance may include:

- Redirection of State funds or State-authorized payments for program services, where possible and consistent with federal and State laws;
- Suspension, modification, limitation, or revocation of the provider's licenses to provide program services;
- Suspension, modification or termination of contracts or other agreements with the covered provider; and
- Any other lawful actions or penalties deemed appropriate by the department or its designee.

## Conclusion

We recommend organizations take the following actions in light of this latest regulatory guidance:

- Determine if your organization's current level of state funding classifies it as a covered provider;
- Prepare the required Executive Order 38 Disclosure Form;
- Take an internal accounting of expenses to determine if your organization meets the 75% requirement for program service expenses;
- If compensation for any executives will exceed or approach the $199,000 cap:
    - Review current contracts for possible extension of the limit until 2014;
    - Determine the funding sources of the executive's compensation;
    - Compare your executives to pay levels at peer organizations, using relevant compensation surveys and compensation professionals as needed;
    - Seek Board approval of compensation after reviewing comparability data;
    - Prepare a waiver application based on the six permitted circumstances.

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