

Assessment of Public Comment on the Revised New

9 NYCRR Part 6157:

“Limits on Administrative Expenses and Executive Compensation”

The Division of Criminal Justice Services (Division) received comments on the revised “Limits on Administrative Expenses and Executive Compensation” regulations published in the *State Register* on October 31, 2012 from four organizations– Safe Horizon, which supports the analysis conducted by the Human Services Council of New York; Lawyers Alliance for New York; Association of Fundraising Professional; and the Charity Defense Council.

Some of the comments focused on issues which had been raised, and already considered and addressed in the Assessment of Public Comment (summary) which was published in the October 31st *State Register* and pertains to the initial proposed regulations. Significant among these comments were: payments through municipal or county contracts should not be considered State-authorized payments; the regulations should cover only State-authorized payments and not other State funds; the minimum State funding should be based on total revenues and not in-State revenues; and eliminate the 75th percentile cut-off. The full Assessment of Public Comment on the original proposed rule is available on the Division’s website at <http://www.criminaljustice.ny.gov/>.

All of the comments received by the Division were taken into consideration. In the first part of this document, the Division summarizes positive feedback and addresses the general comments. In the second half of the document, the Division responds to specific questions, comments and suggestions, which have been grouped according to the part of the rule they address. Comments received and the Division’s responses are grouped as follows:

I. General Comments

Positive Feedback

- We wish to thank Governor Cuomo and his staff for incorporating many of the comments and concerns expressed by the nonprofit sector regarding the initial regulations.
- We appreciate that the regulations have been revised so that many definitions, including “executive compensation” and “covered executive,” better align with existing Internal Revenue Service (IRS) definitions, making it easier for providers to track and report across levels of government.
- Clarifying the definitions of “in-State revenue” and “covered provider” in each of the agencies’ revised regulations is very helpful in educating providers about what types of programs/services are included.
- The revised regulations provide useful clarification of many provisions of the original proposed regulations.
- We support the inclusion of the allocation methodology for differentiation between administrative and program expenses in the regulations.

Issues and Concerns

Executive Order (E.O.) No. 38

Comments:

E.O. No. 38 discriminates against nonprofit organizations. It harms the nonprofits that passionately serve the State of New York, and, ultimately, will hurt the most vulnerable in our communities that these organizations serve. In addition, E.O. No. 38 is deeply flawed. It is based on the erroneous premise that funds expended on administrative costs and compensation are not directly attributable to providing care and clients served by the non-profit. Furthermore, E.O. No 38 is ill-conceived, duplicative, overreaching, and counterproductive. It should be rescinded.

Response:

The Division disagrees. E.O. No. 38, which was issued by Governor Andrew Cuomo on January 18, 2012, provides for a limit on administrative expenses and executive compensation of providers of program services in order to meet the State's ongoing obligation to ensure the proper use of taxpayer dollars and the most effective provision of such services to the public.

The Division is proposing to adopt this regulation, which is required by E.O. No. 38, because the State of New York directly or indirectly funds with taxpayer dollars a large number of tax exempt organizations and for-profit entities that provide critical services to New Yorkers in need, and the goal is to ensure that taxpayer dollars are used properly, efficiently and effectively to improve the lives of New Yorkers. In certain instances, service providers that receive State funds or State-authorized payments have used such funds to pay for excessive administrative costs or inflated compensation for their senior executives, rather than devoting a greater proportion of such funds to providing direct care or services to their clients. Such abuses involving public funds harm both the people of New York who are paying for such services and those persons who must depend upon such services to be available and well-funded. The Division believes that the proposed limitations in the regulation further the legitimate goal of ensuring that public funds are properly expended and the use of such funds is properly monitored.

These regulations provide a benchmark to ensure that State funds or State-authorized payments paid by this agency to providers are not used to support excessive compensation or unnecessary administrative costs. The exclusion of nonprofit organizations would undermine the intent of the regulation because certain organizations may provide program services that should be regulated by this regulation.

Cost and Implementation

Comments:

The proposed regulations state that the cost of implementation is minimal and will be implemented in a way that addresses existing definitions and systems, however every new regulation and reporting scheme creates unnecessary and unfunded, administrative burdens on nonprofits that already function with substantially low administrative rates.

Response:

The costs of implementing this rule to affected providers is still anticipated to be minimal as most, if not all, of the information that must be reported by such providers is already gathered or reported for other purposes.

Comments:

These new regulations have the potential to be very confusing to providers. The Division of Budget and State agencies are asked to execute a series of trainings and written guidelines on compliance to provide clear direction and reduce confusion.

Response:

The regulations require the Division to be responsible for ensuring the necessary reporting and compliance by such covered providers. Accordingly, this concern will be addressed further in the implementation process.

Coordination

Comments:

Nonprofit organizations are already subject to New York Attorney General oversight. The Governor should work with the Attorney General on the implementation of these regulations to ease compliance burdens and reduce redundant paperwork.

Response:

The requirements in these regulations are complementary to, but not duplicative of any existing requirements. The substantive requirements in these regulations provide a new benchmark for both executive compensation and administrative expenses that, for the first time, will help providers and State agencies ensure that clear rules govern both areas. However, for clarification, the proposed regulation has been further revised to clarify which administrative expenses are not included.

Comments:

The State is asked to work closely with localities to provide nonprofits with information about what percentage of local funding is considered State dollars. This is not information that is

usually communicated to contractors and there is the potential for confusion as providers attempt to determine what percentage and amount of State funds they receive.

Response:

The regulations require the Division to be responsible for ensuring the necessary reporting and compliance by such covered providers, and shall issue guidance to affected county and local governments setting forth the procedures by which the Commissioner of the Division or his or her designee shall do so.

Comments:

There should be a regular meeting to ensure that all agencies are implementing the regulations properly and consistently, and the regulations should be revisited to ensure that they are fulfilling the goal of E.O. No. 38.

Response:

The Division agrees and this concern will be addressed further in the implementation process. The Division already anticipates that it will assess the impact of the regulations on salaries, if any, on an ongoing basis, and will make any necessary adjustments to the regulations accordingly.

II. Specific Comments

Definitions

Comments:

“Covered provider” is defined as “any entity or individual” that has received “State funds or State-authorized payments for at least two years prior to the covered reporting period and in an average annual amount greater than \$500,000” to render program services. Additionally, a covered provider must receive at least 30% of its total annual in-State revenue for the year prior to the covered reporting period from State funds or State-authorized payments. Due to inflation and changing economic conditions, it may be necessary to revisit the thresholds at least every five years to ensure that organizations that are properly exempt from E.O. No. 38 remain exempt.

Response:

This suggestion will be addressed further in the implementation process.

Comments:

Perhaps inadvertently, the placement of the qualifying phrase “reportable on a covered executive’s W-2 form” in the definition of “executive compensation” suggests that it may only be applicable to personal use of the organization’s property, and not to other non-salary benefits.

In fact, the reporting of any of the non-cash benefits listed in this definition on a covered executive W-2 form should be equally applicable to all such benefits. The definition should instead read:

Executive Compensation shall include all forms of cash and noncash payments or benefits given directly or indirectly to a covered executive, including but not limited to salary and wages, bonuses, dividends, distributions, and other financial arrangements or transactions reportable on a covered executive's W-2 form, such as personal vehicles, housing, below-market loans, payment of personal or family travel, entertainment, and personal use of the organization's property, except that mandated benefits (e.g., Social Security, worker's compensation, unemployment insurance, and short-term disability insurance), and other benefits such as health and life insurance premiums, and qualified retirement plan pension contributions (including 401 and 403 plans and deferred compensation plans) that are consistent with those provided to the covered provider's other employees shall not be included in the calculation of executive compensation.

Response:

The definition of "executive compensation" was amended.

Comments:

The definition of "program services" does not include "property rental, mortgage or maintenance expenses, except where such expenses are made in connection with providing housing to members of the public receiving program services from the covered provider." However, according to the allocation method used to complete IRS Form 990, expenses related to real property, whether rent, mortgage costs, or maintenance costs, may be allocated between program services and administration based on the actual use of the property. This will add confusion and complexity for nonprofit organizations which must manage their finances according to two different standards, and will impose additional administrative burdens by requiring that organizations use two different methodologies to calculate their program expenses.

Response:

The revised regulations conform some of the requirements to those with which many covered providers must already comply, including provisions incorporating the definitions applicable with non-profits under the IRS Code. However, to ensure clarity, this concern will be addressed further in the implementation process.

Comments:

The Division of Budget and State agencies are encouraged to provide exhaustive lists of what monies fall under "State funds," "State-authorized payments," and "covered providers" so that nonprofits can easily ascertain whether they are subject to these regulations.

Response:

The definitions of “State funds,” “State-authorized payments,” and “covered provider” were amended. “State funds” are those funds appropriated by law in the annual State budget pursuant to Article VII, Section 7 of the New York State Constitution. “State-authorized payments” refer to those payments of funds that are not State funds but which are distributed or disbursed upon a New York State agency’s approval or by another governmental unit within New York State upon such approval, including but not limited to the federal and county portions of Medicaid program payments approved by the State agency. The definition of “covered provider” has been amended to address the individual or entity that has received State funds or State-authorized payments during the covered reporting period and the year prior to the covered reporting period. The definition of “covered provider” requires a contract or other agreement to render program services.

The Division is currently working to publish a list of government programs whose funds shall be considered State funds and State-authorized payments prior to the effective date of these regulations.

Limits on Administrative Expenses

Comments:

Administrative costs are integral to good stewardship of funds and resources and regulatory compliance and are equally necessary in furthering an organization’s charitable mission. State-funded nonprofits will lose the ability to use their best judgment to determine how to operate effectively and efficiently, and will instead be forced to devote significant time and energy to establishing a budget that will allow the organization to function while complying with various sets of restrictions on the use of funds for administrative expenses.

The limitation on the use of State funds for administrative expenses will unduly burden organizations that obtain all, or substantially all, of their funding from the State. It is recommended that agencies periodically re-evaluate the impact of the limitation on the use of State funds for administrative expenses to ensure that organizations are not cutting back on key administrative functions in such a manner as to jeopardize their ability to deliver quality program services.

Response:

The Division believes that the proposed limitations in these regulations further the legitimate goal of ensuring that public funds are properly expended and the use of such funds is properly monitored. These regulations provide a benchmark to ensure that State funds or State-authorized payments paid by this agency to providers are not used to support excessive compensation or unnecessary administrative costs. The restrictions are necessary to accomplish these objectives. However, the suggestion of a periodic review will be addressed further in the implementation process.

Comments:

It is recommended that the regulations clarify that the allocation methodology used for purposes of the IRS Form 990 and audited financial statements, which employs generally accepted accounting principles (“GAAP”), will also satisfy the requirements of the regulations. This will alleviate any potential confusion and make clear that nonprofit organizations are not required to recalculate their allocations for purposes of the regulations and in contravention of GAAP.

Response:

The requirements in these regulations are complementary to those contained in the IRS reporting regime, but not duplicative of any existing requirements. However, to ensure clarity, this suggestion will be addressed further in the implementation process.

Limits on Executive Compensation

Comments:

The revised regulations do not alter the basic framework that was originally proposed and, therefore, will in implementation likely prove contrary to the goals of the regulations: preventing excessive compensation without placing undue burdens on organizations that contract with the State to provide services. The strict limitations on executive compensation are both overly burdensome and unnecessary to accomplish the goals of limiting the compensation of nonprofit executives to reasonable levels. IRS rules already provide guidance to nonprofit organizations in determining reasonable compensation, grant safe harbor protections to nonprofit organizations that comply with the IRS scheme, and provide for penalties for the payment of unreasonable compensation.

Response:

Eliminating the executive compensation requirements would eviscerate one of the key objectives of E.O. No. 38 - limiting the extent of such compensation paid by covered providers that rely to a significant degree upon public funds for their program and administrative services funding. These regulations provide a benchmark to ensure that State funds or State-authorized payments paid by this agency to providers are not used to support excessive compensation or unnecessary administrative costs. The restrictions are necessary to accomplish these objectives.

In addition, the requirements in this regulation are complementary to those contained in the IRS reporting regime, but not duplicative of any existing requirements. The substantive requirements in these regulations provide a new benchmark for both executive compensation and administrative expenses that, for the first time, will help providers and State agencies ensure that clear rules govern both areas. However, for clarification, the proposed regulation has been further revised to clarify which administrative expenses are not included.

Comments:

Tying reasonable compensation to a specific percentile will lead to confusion and uncertainty among the larger, more complex organizations that must pay higher levels of compensations to retain quality employees capable of managing large social service organizations. Many organizations may choose to make significant cuts in the salaries of their top executives, which could result in talented nonprofit managers leaving New York State or the social service sector.

Response:

The goal of the proposed regulation is to ensure that taxpayer dollars are used to provide critical services to New Yorkers in need. However, the Division anticipates that it will assess the impact on salaries, if any, on an ongoing basis, and will make any necessary adjustments to the regulations accordingly.

Comments:

There should be a list of compensation surveys (and other resources) that are free to use and nonprofits can rely on as safe harbor in ensuring that they are within the 75th percentile should be created.

Response:

The regulations reference “compensation survey identified, provided, or recognized by the Division and the Director of the Division of the Budget.” However, this concern will be addressed further in the implementation process.

Comments:

The regulations provide that covered providers that pay more than \$199,000 to covered executives may not be required to seek a waiver if that compensation is not “... greater than the 75 percentile of compensation paid to comparable executives in other providers of the same size and within the same program service sector and the same or comparable geographic area as established by a compensation survey identified, provided, or recognized by the [Division] and the Director of the Division of the Budget.” This approach is problematic in several respects. A better approach would be to permit covered providers to develop and maintain a record of their own comparable salary information or, at a minimum, to explicitly allow the use of surveys based on information about compensation that has been reported for comparable positions at comparable organizations on the IRS Form 990.

Response:

As noted in the comments, the regulations already reference compensation surveys “identified, provided, or recognized by the Division and the Director of the Division of the Budget.” However, this concern will be addressed further in the implementation process.

Comments:

It is unclear whether compensation surveys will be available in time for organizations that may be at or near the 75th percentile to determine if they need to apply for a waiver.

Response:

This concern will be addressed further in the implementation process.

Comments:

Because the regulations use a definition of executive compensation that includes only a portion of the benefits generally reported on the IRS Form 990, the comparability data necessary to assess compensation under the regulations may not be available, and it will be difficult and expensive, if not impossible, for organizations to correctly determine whether they are at or near the 75th percentile.

Response:

The definition of “executive compensation” was amended.

Comments:

The limits on executive compensation and the complex process to ensure compliance may discourage nonprofits from growing as they may be discouraged by the complexity of compliance and will shy away altogether from offering the higher levels of compensation necessary to hire effective leaders to help facilitate growth

Response:

These regulations provide a benchmark to ensure that State funds or State-authorized payments paid by this agency to providers are not used to support excessive compensation or unnecessary administrative costs. The limits are necessary to accomplish these objectives. However, the Division anticipates that it will assess the impact on salaries, if any, on an ongoing basis, and will make any necessary adjustments to the regulations accordingly.

Comments:

The regulations require that executive compensation over \$199,000 must be “approved by the covered provider’s board of directors or equivalent governing body (if such body exists), including two independent directors or voting members...” This requirement does not appear to permit the delegation of the approval of compensation to a committee of the Board of Directors, such as a compensation committee – a common practice by many New York not-for-profit corporations that is permitted by New York law. This provision should be modified to provide

that the compensation must be “approved by the covered provider’s board of directors or any committee with specifically delegated authority, or equivalent body (if such body exists), including two independent directors or voting members, and that action must be reported to the Board of Directors or equivalent body....”

Response:

In response, and taking into account the suggestions submitted, changes were made.

Waivers

Comments:

The waiver process is unnecessarily burdensome, and the outcome is uncertain. The regulations provide that waiver applications must be filed no later than 90 calendar days prior to the reporting period for which waivers are sought. Inasmuch as the limits on administrative expenses and executive compensation apply to reporting periods beginning on April 1, 2013, waivers for the first affected reporting period are due before January 1, 2013. Compliance will require a significant investment of time and resources, making it increasingly difficult for organizations to manage their administrative functions in an efficient manner. It is strongly suggested that the deadline for waiver applications, at least for the reporting period beginning April 1, 2013, be moved back in time to March 1, 2013.

Response:

The revised regulations provided greater flexibility in the filing of a waiver application and also has pushed back the implementation date. However, further amendments were made. The effective dates of provisions in the proposed regulations have been revised to clarify: (a) covered reporting period; (b) submission of waiver applications regarding executive compensation; (c) submission of waiver applications regarding administrative expenses; and (d) reporting periods.

Comments:

The regulations provide that one factor to be considered by the Division and the Director of the Division of the Budget is whether the covered provider’s process for approval of the compensation “... involved review and approval by the board of directors or other governing body....” This provision should be modified explicitly to permit review by a committee of the board with properly delegated authority, with that action reported thereafter to the full board of directors or other governing body.

Response:

In response, and taking into account the suggestions submitted, changes were made.

Comments:

The regulations provide that, “[u]nless additional information has been requested but not received from the covered provider, a decision on a timely submitted waiver application shall be provided no later than sixty (60) calendar days after submission of the application.” However, the regulations do not indicate the consequence if the Division or Director of the Division of the Budget fail to render a decision within that period. It should state that such waiver applications shall be deemed to be granted in the event that a decision is not rendered within the sixty day deadline.

Response:

This concern will be addressed further in the implementation process.

Comments:

The regulations provide for a stay of a denial of a waiver request if the request for reconsideration of that denial is made within 30 days of the denial. Submission of a request for reconsideration “... shall stay any action to deny an applicant’s request for a waiver” but shall also “... stay any action to enter into a contract or other agreement.” The meaning of the latter provision is unclear. The practical consequences of this “stay” should be clarified.

Response:

This concern will be addressed further in the implementation process.