Overview

- Background on the Executive Order: why the not-for-profit sector is its own worst enemy
- What you have to do to comply with the regulations
- Latest guidance and implementation issues
- Legislative developments: Intersection of NFP Revitalization Act and EO 38
- Status of legal challenges
Scandals & regulatory responses

- Self-inflicted wounds: Scandals in state-funded organizations in NYS and across the country have had predictable results
- Excessive compensation issue has arisen over time: United Way, Adelphi University, NYSE, Cuomo (the first) review
- Precipitating scandal: YAI
  - Prompted creation of New York State Task Force on Not-for-Profit Entities, which required reporting of compensation by NFPs
- Continuing focus of media, Congressional oversight committee and the “politics” of executive compensation

Latest scandals/adverse publicity

*Rapfogel to Plead Guilty in Scheme to Steal Millions From Charity*
This just in . . .

At NewYork-Presbyterian Hospital, Its Ex-C.E.O. Finds Lucrative Work
Page 1, New York Times, July 15, 2014

Existing regulation

- Attorney General’s Charity Bureau oversees the operation of the state’s not-for-profit corporations, including the reasonableness of compensation. N-PCL §202(a)(12).
- AG can bring actions against officers and directors and can seek the removal of directors who authorize or acquiesce in excessive compensation. EPTL §8-1.4(m), (n) and N-PCL §112(a)(4), 706(d) and 714(c).
- Various legislative proposals have been advanced that would either strengthen these existing provisions, impose a new cap or supercede Executive Order—none enacted.
New Charities Bureau Chief and Not-for-Profit Revitalization Act

James Sheehan

Related party rules extend to compensation determinations:
- Persons affected by compensation paid to member, director or officer may not attend or participate in deliberation or vote on compensation (but can present information)
- To be approved, related party transactions:
  - Must be fair, reasonable and in the nonprofit’s best interest
  - Directors and officers who have a direct or indirect interest in a related-party transaction must disclose such interest to the board
  - Board must consider alternative transactions to the extent available, and
  - Approved by not less than a majority vote

IRS oversight of NFPs and Executive Compensation

- Excessive compensation paid to board members and the executive leadership of the organization is subject to disclosure and to IRS scrutiny.
- Substantial tax penalties, known as “intermediate sanctions,” are levied on executives that receive excessive compensation (aka, an “excess benefit transaction”)
- Additional liabilities are imposed directly upon the board of a not-for-profit entity that approved the compensation package. IRC §4958.
IRS compensation process requirements

- Entities must demonstrate that the board actually undertook a process to establish the reasonableness of compensation.
- The IRS will presume the reasonableness of a compensation process if:
  - the governing board actually reviews, makes and documents the salary compensation determination,
  - without a conflict of interest, and
  - after obtaining and considering appropriate data and comparability information to make a reasonable fair market determination of an appropriate level of compensation.

2012 Executive Compensation and Administrative Cost Limitations

2012 Budget legislation proposed statutory limit on administrative reimbursement and executive compensation for entities contracting with state.
Budget legislation

- Applied to both for-profits and not-for-profits that contract with nine executive agencies and State Education Department
- Imposed $199,000 Executive Compensation limitation, plus graduated caps on administrative expense (25%-20%-15%)
- Senate hearings held: Senate one-house rejected legislation and expressly overrode Executive Order
- Neither House included legislative proposal in 2012-13 enacted state budget

Executive Order 38 issued with identical limitations, applicable to same executive branch agencies (not State Education Dept.) and both for-profits and NFPs
- EO 38 was a two page order that placed a $199,000 cap on executive compensation and a graduated (25-20-15%) cap on administrative expenses
- Left definitions, process, exemptions, waiver to regulation
Regulations issued

- 13 state agencies issued identical regulations on May 30, 2012
- Applicable to entities whose state funds and state authorized funds constitute 30% of overall revenue and exceed $500,000
- Filled in details on definitions of covered providers, state funds and state authorized funds, applicability to related entities, waiver process and a host of other details—leaving many other elements of rules and process either unclear or unaddressed
- Revised regulations published in Fall

Regulations finalized

- Another draft of regulations issued on March 13, 2013, new comment period
- Deferred effective date until 7/1/13 (or 1/1/14), depending on applicable fiscal year/cost reporting period
- Clarified impact on related parties and subcontractors
- Exempted “program responsibilities” from executive compensation caps, limited to top ten employees
- “Grandfathered” prior contracts
- Adopted as final regulations on May 29, 2013, effective July 1, 2013
The big picture

- Applies to entities that receive more than $500K over 2 years and whose state funding equals more than 30% of total
- Hard cap on using state funds/state-authorized payments to pay more than $199,000 cap on executive compensation, unless receive waiver
- Can exceed amount with non-state funds if
  - below 75th percentile of comparable executives and follow appropriate compensation process, or
  - apply and receive waiver
- Administrative expense limit of 25% in 2013, 20% in 2014 and 15% thereafter
- Effective on 7/1/13—but applicable to providers based on their reporting or fiscal years

Fine print: Applicability

- Who’s a covered provider?
  - For-profit or not-for-profit, but not governmental
  - $500,000/30% in state/state-authorized funds
  - May apply to related organizations/subcontractors
- What are state/state-authorized funds?
  - Medicaid and Medicaid managed care count
  - Local spending of state funds
  - List of state/state-authorized funds
- Key elements of calculation
  - Total state/state-authorized funding
  - Calculate percentage of overall in-state revenue deriving from those funds
Fine print: Executive Comp

What is executive compensation?
- Salary plus bonus, other “executive” perks, like vehicles, housing, travel, entertainment
- Includes dividends, profits (for-profit)
- Not mandated benefits, health/life insurance, qualified pension/deferred comp plans “consistent with those provided to other employees”

Who is covered executive?
- 990 definitions/limited to ten highest >199K
- Program-related roles excluded, wholly/partly
- Certain related organization execs may also be subject to cap, if satisfy 30% threshold

If there are no non-state funds to supplement compensation, must seek waiver if over 199K

If have non-state funds, may exceed amount if:
- Less than 75% of comparable executives per comp survey “identified, provided or recognized by the State”: guidance awaited on calculation of comparability; and
- Reviewed and approved by board/comp committee
- If compensation doesn’t satisfy these standards, may seek waiver
Fine print: Executive Comp

- Calculate gross compensation, including countable benefits, bonuses, etc.
- Identify top ten executives over $199K
- Determine amount of compensation, if any, related to program services and deduct
- Demonstrate that any payment over 199K was paid with non-state funds—or seek waiver
- If supplemented by non-state funds, document that compensation is below 75th percentile of comparable executives and was properly approved by board—or seek waiver
- Latest guidance on comparability analysis

Fine print: Executive Comp

- What about my contract?
  - Will trump regulations if entered into before July 1, 2012
  - But will require waiver if it extends beyond April 1, 2015
  - And any renewal must be in compliance with regulations
  - Contracts post 7/1/12—and everyone post-4/1/15—are subject to regulations, regardless of contract
Initially, 75% of operating expenses paid with state/state-authorized funds must be devoted to program, rather than administrative, costs

Program expense ratio increases by 5% annually thereafter until reaches 85% in 2015 and thereafter

Calculate cap by first determining total “covered operating expenses”: the sum of program services expenses and administrative expenses

Of that total, calculate total of “program services expenses”: program salaries/benefits (including supervisory staff), QA, other (including travel, supplies, training, IT) that are program-related

Program services do not include: capital expenses, property expenses (except for expenses for housing public receiving program services), taxes, equipment/vehicle rental, unanticipated, non-recurring expenses, policy development/research
Calculate **administrative expenses**: 
- Includes management/overhead expenses, including CEO, CFO, accounting, billing, HR, PR, IT (where not otherwise attributed directly to program)
- Legal expenses that are non-program-related
- Office expenses, including telecommunications, computers, dues, licenses, subscriptions, conference expenses, PR reports, insurance premiums, *where such expenses cannot be attributed directly to program services*

Capital, property rental, taxes, equipment/vehicle rental, unanticipated, non-recurring expenses, policy development and research also excluded here

As a result, certain expenses don’t count as *either* administrative or program expenses

With these totals, calculate whether administrative expense exceeds relevant threshold of covered operating expenses (25%, 20%, then 15%)
Executive Comp Waivers

- Must be timely: submitted with report form, six months post-reporting year
- Need to register with on-line portal for waiver submission
- Granted for good cause
- Limited appeal rights
- Waivers are time-limited, may be revoked
- Limits increases to 5% per year
- Information provided not FOILable

Factors for waiver include
- Comparable executive compensation
- Necessity to pay above cap
- Nature, size, complexity of organization
- Compliance with compensation process
- Qualifications and experience required
- Efforts to fill position without waiver

Can seek waiver for unfilled position
Administrative Cap Waivers

- Same timing requirements
- Valid for reporting period
- Extensions may be requested
- Application not subject to FOIL
- Same limited appeal rights

Factors include:
- Unavoidable and necessary costs
- Negative impact on program
- Nature, size, complexity of program
- Efforts made to reduce costs
- Efforts to supplement state funding to pay higher costs
Reporting

- EO 38 Disclosure Form
- Due “no less than 180 calendar days following the reporting period”
- Must complete form and submit whatever other information may be requested
- Failure to report could result in termination of contracts or agreements
- Developing on-line portal for submission

Penalties/Enforcement

- Notice of non-compliance
- Corrective action period and plan
- Failure to implement corrective action may result in:
  - A second chance
  - Loss of state funds, suspension of license, termination of contracts or any other penalty deemed appropriate
- Appeal
Key documents/resources

- OMH Regulations: 14 NYCRR Part 513
- Official website: executiveorder38.ny.gov
- Preliminary Guidance: Executive Order #38 and Related Regulations
- Various worksheets and forms on above site
- Frequently Asked Questions (posted in last month)

Current status

- Reports due by December if on 7/1-6/30/13 year
- Guidance issued and updated on ExecutiveOrder38.ny.gov
- Implications of NFP Revitalization Act
- Despite waning interest in executive branch and periodic efforts by Legislature to either codify or repeal, EO 38 is here to stay, at least for now
- Only hope: legal action
See you in court

- Concerned Home Care Providers v. NYS Dept of Health (7/10/2013, Suffolk Co.)
- Agencies for Children’s Therapy Services, Inc. v. NYS Department of Health (4/9/2014, Nassau Sup. Ct.)
- LeadingAge of NY, et al. v. Shah (Albany County)

Status of cases and Executive’s position
Implications for OMH-regulated providers

The legal argument

Key arguments:

- Absence of statutory authority, with unique legislative history: Boreali v. Axelrod
- Limits of Executive Orders Rapp v. Carey
- Impairment of contracts
- Authority of State to regulate compensation paid with non-state funds
Executive compensation and big gulp soda

In the Matter of New York Statewide Coalition of Hispanic Chambers of Commerce, et al. v. NYC Dep't of Health and Mental Hygiene, Court of Appeals, June 26, 2014

- Challenged “Sugary Drinks Portion Cap Rule”
- September, 2012, NYC Board of Health adopted rule banning sale of sugary drinks in larger than 16 ounce containers
- Court upheld lower courts invalidation of the requirement, based largely on Boreali v. Axelrod's criteria that determine when administrative agency has “engaged in law-making and thus infringed upon the legislative” role

The issue in context

- Role of NFP sector in New York:
  - Employs 1 in 5 New Yorkers
  - 9 of top 20 employers are NFPs, 4 of top ten
  - Provide bulk of health, behavioral health, social and human services
- What can NFPs do to protect themselves from these periodic assaults?
Questions/Comments

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