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June 17, 2013

**New Regulations on Executive Compensation and
Administrative Costs for State Contractors**

On May 13, 2013, thirteen state agencies issued final regulations governing the payment of executive compensation and administrative expenses by nonprofits and businesses that receive a substantial amount of funding from the state. The regulations were issued pursuant to Governor Cuomo's Executive Order 38 of 2012. The agencies issued three different versions of draft regulations. Lawyers Alliance commented on all three versions, prompting the agencies to issue several useful clarifications.

A. Covered providers

To be covered, a nonprofit must receive on average more than \$500,000 yearly from one or more of 13 New York State agencies, either directly or through an agreement with another state or local entity or other organization. The payments must be in exchange for services (providers of pharmaceuticals and other goods are exempted). In addition, the nonprofit must receive at least 30% of its annual in-state revenues from the State. The 13 agencies that have issued these regulations are:

1. Department of Health
2. Office for People with Developmental Disabilities
3. Office of Mental Health
4. Office of Alcoholism and Substance Abuse Services
5. Office of Children and Family Services
6. Office of Temporary and Disability Assistance
7. Office for the Aging
8. Division of Criminal Justice Services
9. Office of Victim Services
10. Department of Corrections and Community Supervision
11. Department of Agriculture and Markets
12. Division of Housing and Community Renewal
13. Department of State

If a nonprofit receives the requisite amount of funding from one of these agencies, it must comply with limits on administrative expenses and executive compensation. As a rule, the limits take effect on the first day of the provider's first reporting period after July 1, 2013. A provider may decide whether to use as its reporting period the calendar year or, where applicable, the fiscal year used by a provider (except that Medicaid and Medicare contractors required to file an annual Cost Report with the State must use the reporting period applicable to that Cost Report).

Certain categories of providers are categorically exempt from the regulations. For instance, certain child care subsidies (those authorized by Article 6, Title 5-C or Section 410 of the Social

Services Law) do not count towards the \$500,000 threshold for coverage. Nonprofits should consult with the contract officers at the state agencies from which they receive funding to determine whether they are covered.

B. Limits on Administrative Expenses

Starting on the first day of the provider’s reporting period after July 1, 2013, each covered provider can devote at most 25% of its state funding to administrative expenses. This amount will decrease by 5% each year until 2015, when the cap will be 15%.

C. Limits on Executive Compensation

The limits on executive compensation have two parts: one applying to the use of state funds, and the other applying to total compensation from state and non-state sources.

1. Use of state funds: Starting on the first day of the provider’s reporting period after July 1, 2013, each covered provider may not use more than \$199,000 in state funds annually to pay compensation to covered executives, unless it obtains a waiver from the State.

2. Total compensation from any source: Covered providers may use non-state funding to pay compensation in excess of \$199,000, but only if they either obtain a waiver from the state or fulfill both of the following criteria:

1. the compensation is equal to or less than 75% of compensation given to comparable executives in organizations “of the same size and within the same program service sector and the same or comparable geographic area,” as established by a compensation survey recognized by the Division of the Budget, and

2. the compensation was reviewed and approved by the provider’s board of directors or equivalent governing body, including at least two independent directors, and the review assessed appropriate comparability data. (If the review is conducted by a compensation committee, it must be reviewed and ratified by the full board.)

The agencies have stated that they will identify salary surveys or other comparability data before July 1, 2013, although as of late June they have not done so.

3. Exceptions: Among the exceptions to the executive compensation limits are:

1. The limits do not limit state reimbursement for “reasonable compensation paid to a covered executive for program services,” which are defined as “those services rendered by a covered provider or its agent directly to and for the benefit of members of the public (and not for the benefit or on behalf of the State or the awarding agency) that are paid for in whole or in part by State funds or State-authorized funds.”
2. The limits do not apply to compensation pursuant to a contract entered into earlier than July 1, 2012 that does not extend beyond April 1, 2015.

D. Waivers

A covered provider desiring a waiver of either the administrative expenses or executive compensation requirements must apply within 180 days of the end of the reporting period. Waiting to apply for a waiver is not recommended, however, because if a waiver is denied it is unclear what will be required of a provider that incurred administrative expenses or paid executive compensation in excess of the limits.

E. Reporting

The 13 agencies will develop a form, to be called an “EO#38 Disclosure Form,” which covered providers will have to submit within 180 days after the end of the reporting period.

F. Penalties

If an agency finds a provider in violation of the regulations, it must provide notice and a six-month period for provider to cure the violation. At the end of that six-month period, however, the agency may impose sanctions including redirection of state funds; suspension, modification, limitation, or revocation of the provider’s license to deliver the services; suspensions, modification, or termination of contracts; or other penalties.

This alert is meant to provide general information only, not legal advice. Lawyers Alliance staff are available to help qualifying nonprofits assess their executive compensation for compliance with these regulations. Please contact Judith Moldover at (212) 219-1800 x250 or visit our website www.lawyersalliance.org for further information.

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