

**Action Memo**  
Exempt Organizations  
May 2012

## Proposed New York Regulations Limit Executive Compensation and Administrative Expenses for Certain State Funded Service Providers

On May 16, 2012, Governor Andrew Cuomo announced the issuance of proposed regulations by thirteen New York State ("State") agencies that would impose significant executive compensation and administrative expense spending limits on not-for-profit and for-profit entities (as well as certain individuals) that receive specified levels of State funds or State-authorized payments of funds (collectively, "State Funds"). These proposed regulations ("Proposed Regulations") are scheduled to take effect on January 1, 2013, and implement Executive Order 38 that was issued by Governor Cuomo on January 18, 2012 (that Executive Order is summarized in our February 2012 Exempt Organizations Action Memo). The Proposed Regulations generally are the same for the thirteen state agencies, except for minor modifications that apply with respect to a particular agency.

The executive compensation and administrative expense requirements in the Proposed Regulations will be of interest not only to covered employers and individuals, but also to any person who is serving on a board of directors or other governing body of an entity that will need to comply with those requirements.

Public comments on the Proposed Regulations can be submitted during a 45 day period starting on May 30, 2012. In light of the rapidly approaching January 1, 2013 effective date, it is anticipated that the Proposed Regulations will be finalized relatively quickly.

### **What Executive Compensation Spending Limits Are Imposed By the Proposed Regulations?**

The Proposed Regulations would generally restrict certain entities, individuals, and related entities from using State Funds for "executive compensation" given directly or indirectly to a covered executive in an amount greater than \$199,000 annually (the \$199,000 limit may be increased in the future by the State based on appropriate factors). If a covered entity or individual would like to pay a covered executive more than \$199,000 the amount above \$199,000 must be from sources other than State Funds. In addition, the covered entity or individual generally will be able to do so as long as:

- the "executive compensation" for that executive is not greater than the 75th percentile of the "executive compensation" provided to comparable executives for other providers of the same size, within the same program service sector, and in the same or a comparable geographic area, as established by a State-approved compensation survey;
- the "executive compensation" for that executive was reviewed and approved by the applicable board of directors or equivalent governing body (including at least two independent directors or voting members), and such review included an assessment of appropriate comparability data; and
- contemporaneous documentation is available for inspection by the State or its designee that substantiates that the requirements described in this paragraph have been satisfied.

"Executive compensation" includes all forms of reportable cash and noncash payments or benefits given directly or indirectly to a covered executive, other than certain mandated benefits and certain health insurance premiums and pension contributions. The Proposed Regulations include detailed definitions of the terms "executive compensation" and "covered executive." The Proposed Regulations also have special requirements for (1) certain program services rendered by a covered executive outside of his or her managerial or policy-making duties, (2) covered entities or individuals with multiple sources of State Funds, and (3) subcontractors and agents of covered entities or individuals.

If a more stringent limit on executive compensation applies under any separate law or contract, that more stringent limit will control over the less stringent limit in the Proposed Regulations.

If a covered entity or individual will not be able to satisfy the executive compensation spending limits in the Proposed Regulations, it can apply for a waiver from those limits if certain requirements are satisfied.

Employers and individuals affected by the new executive compensation requirements in the Proposed Regulations should review those requirements to determine what impact, if any, they will have on:

- their executive compensation agreements;
- their executive compensation approval procedures; and
- their executive compensation reporting requirements.

### **What Covered Entities or Individuals Will Be Subject To the Executive Compensation and Administrative Expense Spending Limits in the Proposed Regulations?**

A not-for-profit or for-profit entity, as well as certain individuals, generally will be subject to the executive compensation and administrative expense spending limits in the Proposed Regulations if the requirements in this paragraph and the following paragraph are satisfied (each such entity or individual satisfying those requirements is referred to in the Proposed Regulations as a "Covered Provider"):

- the Covered Provider has received pursuant to an agreement with a governmental entity State Funds to render program services for at least two years prior to and during the applicable reporting period, and the average annual amount of State Funds was greater than \$500,000 during those three years; and
- at least 30 percent of the Covered Provider's total annual in-state revenues for that most recent reporting period were derived from State Funds (special requirements apply for parent corporations and subsidiary corporations).

As an exception to the preceding paragraph, the following entities and individuals will not be considered Covered Providers:

- state, county, and local governmental units in the State, tribal governments for the nine State recognized nations, and any of their subdivisions or subsidiaries;
- certain individuals or entities providing child care services who are in receipt of child care subsidies pursuant to Title 5-C or Section 410 of the New York Social Services Law; and
- individual professionals who provide program services and receive State Funds individually, as opposed to receiving State Funds as an employee or officer of a corporation or other entity.

## **What Spending Limits On Administrative Expenses Are Imposed By the Proposed Regulations?**

The Proposed Regulations generally provide that at least 75 percent of a Covered Provider's covered operating expenses paid for with State Funds will have to be used for program services expenses rather than administrative expenses. This 75 percent limit will be increased by 5 percent each year, until it reaches 85 percent for 2015 and subsequent years.

Detailed definitions of the terms administrative expenses, covered operating expenses, and program services expenses are included in the Proposed Regulations. The Proposed Regulations also have special requirements for (1) subcontractors and agents of Covered Providers, (2) Covered Providers receiving State Funds from a county or local government, and (3) Covered Providers with multiple sources of State Funds. If a more stringent limit on administrative expenses applies under any separate law or contract, that more stringent limit will control over the less stringent limit in the Proposed Regulations.

A waiver from the spending limits on administrative expenses can be obtained if certain requirements are satisfied.

## **What Are the Potential Sanctions If There is a Failure to Comply With the Limits on Executive Compensation and/or Administrative Expenses In the Proposed Regulations?**

If a Covered Provider fails to comply with the limits on executive compensation and/or administrative expenses in the Proposed Regulations, the Covered Provider generally will receive a notice of preliminary determination of non-compliance. If the State determines that a violation of any of those limits has occurred, the Covered Provider generally will then receive a notice of a right to cure that violation. If a Covered Provider fails to cure a violation within the time period specified by the State, the State will have the right to issue a notice of proposed sanctions that could include some or all of the following sanctions:

- a possible redirection of applicable State Funds;
- a suspension, modification, limitation or revocation of the Covered Provider's applicable State license(s);
- a suspension, modification, or termination of applicable agreement(s) with the Covered Provider; or
- any other lawful action or penalty that is considered appropriate by the State.

A Covered Provider will have certain rights to appeal any notice of proposed sanctions it receives.

## **What Reporting Requirements Are Imposed By the Proposed Regulations?**

The Proposed Regulations provide that each Covered Provider must submit a completed disclosure report form for each applicable calendar year or fiscal year. Governor Cuomo's May 16, 2012 announcement ("Announcement") indicated that each Covered Provider will be required to report annually:

- the amount of public funds it has received;
- the amount of compensation that has been paid to its executives and highest-paid employees; and
- the amount of its administrative expenses.

The Announcement also indicated that a Covered Provider will be able to file these annual reports “using a simple, state-wide form,” and that it will not be necessary to file with multiple State agencies.

If a Covered Provider fails to satisfy this annual reporting requirement, or to provide additional or clarifying information when requested by the State, the applicable agreement(s) for State Funds could be terminated.

If you have any questions about this memorandum, please contact any of the members of our Exempt Organizations Practice Group listed below.

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