

MEMORANDUM

TO: NYS CLMHD MEMBERS
FROM: JEREMY DARMAN
DATE: JUNE 12, 2012
RE: EXECUTIVE ORDER #38: LIMITS ON EXECUTIVE PAY AND ADMINISTRATIVE EXPENSES

Introduction

On January 18, 2012 Governor Andrew M. Cuomo issued Executive Order #38 directing several state agencies to issue regulations to limit administrative expenses and executive compensation for providers receiving State funds and other State-authorized funds. The proposed regulations under this order were published in the State Register on May 30, 2012 and public comments will be due to most agencies within 45 days, or until July 14, 2012 (OPWDD comments are due on July 23, 2012 as this agency will hold public hearings which delay the close of the comment period).

This memo should only be used to give members a broad understanding of the regulatory proposals, and to stimulate feedback prior to the Conference completing formal comments on the regulations. Links to the actual regulations for the three primary agencies under Local Governmental Unit purview (OASAS, OMH, OPWDD) have already been provided and members should go directly to the proposed regulatory language for a detailed understanding of the proposal and the many definitions created under this proposal (links are also on the final page of this memo). While each agency is required to promulgate their own set of regulations, it appears upon cursory review that the language for OASAS, OMH, and OPWDD is nearly the same (with the exception of some technical items such as legislative basis, the ordering of sections, and references to agency names). For purposes of my own review and any language quoted below, the OMH version, proposing a new Part 513, was used.

Once comments have been collected by each of the State agencies in July, the agencies are required to assess and address each comment (similar comments can be addressed collectively), and if it is determined that a substantial revision of the regulations is required, the proposal must be re-submitted for a second round of comments. In the absence of any changes that would materially alter the purpose, meaning or effect of the regulations, they will be adopted (although the regulations would, for the most part, still not go into effect until January 1, 2013).

Applicability

Covered providers regulated by the following agencies:

- Office for the Aging
- Department of Agriculture and Markets
- Office of Alcoholism and Substance Abuse Services
- Office of Children and Family Services
- Department of Corrections and Community Supervision
- Division of Criminal Justice Services

- Department of Health
- Division of Housing and Community Renewal
- Office of Mental Health
- Office for People with Developmental Disabilities
- Department of State
- Office of Temporary and Disability Assistance
- Office of Victim Services

Covered provider is defined in the regulation as an “entity or individual that:

- i. has received pursuant to contract or other agreement with the [applicable State agency], or with another governmental entity, State funds or State-authorized payments to render program services for at least two years prior to and during the covered reporting period and in an **average annual amount greater than \$500,000** during those three years; **and**
- ii. **at least thirty (30) percent** of those total annual in-state revenues for the most recent reporting period were derived from State funds or State-authorized payments. Where the covered provider is organized as a part of a corporate structure that includes a parent and a subsidiary corporation, the total annual in-state revenues shall be measured as consolidated at the parent level.”

A *covered provider* **does not include State, county, or local governmental units** in New York State, or the nine New York State recognized tribal governments (there are additional exemptions in the regulations).

While the proposed regulations acknowledge that providers will often be regulated and receive funding from multiple impacted state agencies (all funding streams will be combined to calculate applicability and consequent restrictions), there appears to be no contemplation of duplicative and overlapping oversight of the Executive Order #38 provision for some providers.

Limitation on Administrative Expenses

Beginning January 1, 2013, no more than 25% of a provider’s covered operating expenses paid for by State funds or State-authorized payments shall be administrative expenses rather than program services expenses. This cap on administrative expenses will lower by five percentage points each year until January 1, 2015 when it becomes and will remain at 15%.

Covered operating expenses shall only include program services expenses and administrative expenses authorized under applicable state agency regulations, contracts or other rules governing reimbursement of State funds or State-authorized payments. This does not include capital expenses, property rental, and equipment rental, including expenditures for vehicles and “fixed, major movable and adaptive equipment.” By applying the administrative cap limits only against a smaller universe of “covered operating expenses,” the regulations limit some of the inherent advantages of larger organizations and those with diversified funding streams such as grants, fund raising, and self-pay clients. However the larger providers’ economies of scale will still put smaller organizations at a relative disadvantage.

Administrative expenses are defined very broadly in the proposed regulations, though all must meet the standard in which the expense “cannot be attributed to particular program services” (for salaries and benefits) or “cannot be attributed directly to the provision of program services” (for legal expenses and office operations expenses). It is unclear how direct attribution to program services will be determined, and whether there will be some measure or test to determine the “direct-ness” of any attributed expense to determine whether it is an administrative vs. program expense. Furthermore, it is unclear why the direct-attribution language differs between salary/benefit administration and that for other types of administrative expenses.

Below is a listing of expenses deemed *administrative* and therefore subject to the cap under the proposed regulations.

ADMINISTRATIVE COSTS INCLUDE

i. Salaries and benefits of staff performing administrative and coordination functions that cannot be attributed to particular program services, including:

- Executive director/CEO
- Financial officers (CFO, controller, accounting)
- Billing staff
- Human resources/personnel staff
- Public relations
- Administrative office support
- Information technology personnel

ii. Legal expenses that cannot be attributed directly to the provision of program services

iii. Expenses for office operations that cannot be attributed directly to the provision of program services, including:

- Telephones
- Computer systems and networks
- Professional and organizational dues
- Permits
- Subscriptions
- Publications
- Audit services
- Postage
- Office supplies
- Conference expenses
- Staff development
- Publicity and annual reports
- Insurance premiums
- Interest charges and equipment that is expensed (not depreciated)

ADMINISTRATIVE COSTS DO NOT INCLUDE*

i. Capital expenses, including but not limited to installation and maintenance of real estate or other real property

ii. Property rental/maintenance expenses

iii. Equipment rental, depreciation and interest, including vehicle and fixed, major movable and adaptive equipment expenses

*Neither administrative nor program expenses include these costs

The inverse to administrative expenses, *program services expenses* are expenses incurred “in direct connection with the provision of program services,” and are by definition not applied to the administrative costs limitation. These include salaries and benefits of direct service staff and support staff whose work is *attributable to and contributes directly to program services*. Such expenses may include quality assurance and supervisory costs when such work is attributable to the direct staff services. Costs for travel and supplies that are directly linked with specific program objectives may also count as program expenses. Also exempt from program services expenses (and therefore not calculated into the covered operating expenses denominator) are capital, property rental, and equipment rental.

Limitations on Executive Compensation

The executive compensation cap section begins with a “hard cap” provision stating that covered providers and related entities which are funded entirely through State funds or State-authorized, that such payments cannot either directly or indirectly provide executive compensation in excess of \$199,000 per year (this figure may be adjusted annually by the Division of Budget, e.g. for inflation).

A second provision applies to covered providers funded through more than state money and includes more loopholes (and a broader calculation of funds associated with executive compensation) to allow greater levels of compensation; and prescribes the process that covered entities must follow to legitimately dispense levels of compensation exceeding the hard cap. It is worth noting that “executive compensation” may be a misnomer for this proposal as it will apply far more broadly than CEOs- often through several layers of staff associated with administrative functions, and potentially to independent contractors, based in part on the broad definitions of “covered executive” and “executive compensation” that are given on page 5.

Beginning January 1, 2013 covered providers will be subject to penalties set forth in these regulations when such provider or a related entity compensates executives in excess of \$199,000 per year (including not only State funds and State-authorized payments but also any other sources of funding) **AND:**

1. Such executive(s) compensation exceeds the 75th percentile of compensation for “comparable executives in other providers of the same sized and within the same program service sector and the same or comparable geographic area” as identified by the relevant agency and DOB through a compensation survey; **OR**
2. Such compensation was not reviewed and approved by the relevant board of directors/governing body including at least two independent directors or voting members **or** such review did not include comparability compensation data; **AND**
3. Covered provider or related entity is unable to substantiate the requirements established in the above (1) and (2) with a sufficient level of detail.

Subcontractors and agents of covered providers will also be subject to limitations on executive pay, to the extent that such subcontractor or agent has received State funds or State-authorized payments from the covered provider. This category goes beyond the executive compensation limitations to covered

executives of “related entities” referenced in the “covered executive” definition below, and could conceivably apply to the independent consultants and attorneys to the extent that such consultants/contractors are paid with some (unspecified how much) amount of State funds or State-authorized payments.

Important definitions for Executive Compensation:

Covered executive is defined as “a director, trustee, managing partner, or officer whose salary and/or benefits, in whole or in part, are administrative expenses, **and any employee** whose salary and/or benefits, in whole or in part, are administrative expenses and whose executive compensation during the reporting period equaled or exceeded \$199,000. In the event that a covered provider contracts with a related entity for administrative or program services, the covered executives of the related entity shall also be considered “covered executives” of the covered provider.” (emphasis mine)

Executive compensation is defined as “all forms of reportable cash and noncash payments or benefits given directly or indirectly to a covered executive, including but not limited to salary and wages, bonuses, dividends and other financial arrangements or transactions such as personal vehicles, meals, housing, personal and family educational benefits, 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 disability insurance), and health insurance premiums and pension contributions consistent with those provided to a covered provider’s non-covered executive employees shall not be included in the calculation of executive compensation.”

Waiver of Regulations

There is a waiver process for providers seeking exemption from the administrative expense and/or executive compensation limitations. The application and appeal process for such waivers is outlined in detail in the regulations.

Sanctions

For covered providers that do not obtain a waiver and violate the limitations set by Executive Order #38, there are penalties that may be applied by the regulating agency. Penalties will likely be levied progressively, beginning with a notice of non-compliance and corrective action plan, followed by more punitive measures for the failure to follow a corrective action plan (CAP). Penalties for non-compliance and/or failure to follow a CAP can include the redirection of funds from an administrative into a program area by the oversight agency, suspension or limitation of funding, suspension or limitation of contracts, and termination of a provider’s license.

Some Considerations for Analysis, Discussion, and Comment

Administrative Expenses:

- Are the administrative expenses as defined and listed in this proposal an accurate reflection of “administration” or “administrative overhead” as used by LGUs and providers currently?
- Is the “direct attribution” standard that would exempt an activity from the administrative side of the ledger sufficiently explicit? Should there be more specificity on “direct-ness?”
- Are any of the administrative expenses listed specifically mandated by State or Federal law or regulation (making it difficult to reduce such expense)?
- Any considerations for how administrative tasks could be measured more or less accurately by the implementing agencies to prevent overestimation or manipulation of numbers?
- How would administrative expenses as defined be advantageous or disadvantageous to certain classes, sizes, or types of provider agencies?

Executive Compensation:

- Do any of your providers to your knowledge use State funds or State-authorized payments to pay for contractors to the extent that this proposal would bring these consultants under the auspice of these compensation limits?
- Are the loopholes allowing executive compensation in excess of \$199,000 reasonable and will they sufficiently allow legitimately well-paid executives to continue operating in their positions?

Other Considerations

- Are the criteria and definitions in this proposal clear enough for you to understand? For example, are you clear, based on the definitions of “state funds” and “state-authorized payments,” where all payer sources to your voluntaries will fall (grant funds, commercial insurance, Medicare, etc.)?
- Is there any specific information that LGUs will need from the regulating agencies, under the requirement that such agencies provide local governmental entities with guidance on the process they will use to collect executive and administrative expense data from providers?
- Any comments or recommendations regarding the oversight of and collection of information from providers receiving State funds from multiple agencies subject to this proposal?

Useful Links

Executive Order #38: <http://www.governor.ny.gov/executiveorder/38>

May 30, 2012 State Register notice: <http://www.dos.ny.gov/info/register/2012/may30/pdfs/rules.pdf>

Links to proposed regulations are on each agency’s website:

[OASAS](#)
[OMH](#)
[OPWDD](#)
[DOH](#)