



**TESTIMONY BEFORE THE SENATE COMMITTEE
ON INVESTIGATIONS AND GOVERNMENT OPERATIONS**

**Executive Compensation at Not-for-Profit Organizations
Receiving State Funding**

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Hearing Room A, Legislative Office Building**

Testimony of:

NEW YORK STATE REHABILITATION ASSOCIATION

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Senator Marcellino and Committee Members: NYSRA greatly appreciates your invitation to appear in person to deliver testimony at this hearing on an important topic. Unfortunately, because of the change in date of the hearing, we are unable to personally appear. We are grateful for the opportunity to submit the following written testimony and apologize for our being unavoidably unable to attend.

INTRODUCTION

NYSRA, formed more than 30 years ago, is a statewide trade association of not-for-profit providers of services to New Yorkers of differing abilities. Our providers and their direct-care staff are key components of the state's delivery system of services to people with developmental disabilities, mental health diagnoses, learning disabilities, and other conditions. Our approximately 100 provider agencies deliver myriad services to New Yorkers, including vocational rehabilitation, residential care, day programs, clinical services, and other supports.

In recent months, questions have surfaced in New York State around the compensation of executives at not-for-profit organizations that receive funding from State revenue sources. Notably, news articles focusing on a small number of such agencies licensed by and funded through the Office for People With Developmental Disabilities (OPWDD) have been published and served as the foundation for public discourse on the matter of compensation of executives.

In January, Governor Cuomo, through his submitted Executive Budget for the 2012-2013 State Fiscal Year as well as in a separate, virtually identical Executive Order, has further focused attention on compensation and operations of agencies (both for- and not-for-profit) that provide services under contract with the State. The Governor proposes certain limitations on state reimbursement of executive salaries at such agencies and also prescribes the percentage of state funds that must be used for services, rather than administration, of the agencies.

NYSRA agrees that such issues are pertinent. It does not condone wasteful spending by any entity with which the State contracts to provide services and supports to New Yorkers who need them. We understand both the concerns of the Governor and this Committee with regard to appropriate spending and service delivery. As outlined below, however, we believe there are ways to protect the taxpayer, ensure effective and efficient service delivery to people in need, and guarantee the integrity of the systems in issue without further legislation or policy change.

EXISTING STATE MECHANISMS

The not-for-profit agencies that constitute NYSRA's membership are community, mission-driven organizations governed by volunteer Boards of Directors. These Boards are populated by community-minded citizens and taxpayers who work to ensure that services and supports are delivered to New Yorkers who need them by responsible not-for-profit agencies. These agencies are subject – as they should be – to close regulation by the State government, whose interest lies

both in the guarantee of service delivery to people in need as well as in protecting the public purse.

Our agencies operate under myriad rules, regulations, licensing requirements and statutes. Among these are the Not-for-Profit Corporations Law, the Estate Powers & Trusts Law, various Public Health statutes, the Mental Hygiene Law, Medicaid rules and regulations, and statutory and common-law provisions regarding fraud. State oversight of our agencies is seated in the Attorney General, the Office for People with Developmental Disabilities, the Office of Mental Health, and the Office of the Medicaid Inspector General. In various ways and to varying degrees, all of these State agencies prescribe – and proscribe – practices with regard to the operation of community-based agencies that provide services to people they serve.

These controls and this oversight regarding service providers are substantial. Not-for-profit organizations delivering service to needy New Yorkers are subject to audits from multiple agencies, quality assurance guidelines, and oversight that is designed to ensure both the efficacy of their services and their integrity of their operations.

Aside from the notable exceptions that have been the subject of recent publicity and attention, we are not aware that there is widespread abuse of the public trust by our agencies. We believe the abuses that have been reported – which are very few – are, in fact, extraordinary exceptions, newsworthy for their rarity. Existing mechanisms work to make this so. We believe it should be noted that one exception, publicized last summer, was itself the result of an investigation by the Office of the Attorney General that resulted in the departure of executives from the not-for-profit being examined. Existing protections do, in fact, work to identify and resolve such situations – as they should.

FEDERAL IRS APPROACH

Given the significant role played by Medicaid in New York's systems of services and supports for people with disabilities, a great deal of federal oversight of provider operations is present on a regular basis. Providers are subject to a considerable federal, as well as State, scrutiny.

For the purposes of this hearing, however, perhaps the most pertinent requirements are those of the Internal Revenue Service (IRS) and its governing powers relating to not-for-profit status of our community service providers. For many years the IRS has applied an executive compensation analysis that focuses attention on not-for-profit boards, their governance principles and the integrity of their operations with regard to setting salaries of agency executives. This is done both through statute and regulation.

Internal Revenue Code §4958 identifies highly specific requirements imposed on governing boards of not-for-profit corporations and their oversight. Moreover, Treasury Regulation 53-4958-6, read in conjunction with the authority in the above-cited statute, sets out a process regarding necessary and proper practices when establishing executive compensation for Internal Revenue purposes such as maintaining or revoking not-for-profit status. We advocate very

strongly with our members to see that all boards of directors follow the statute and regulation closely.

Those that do comply – and such compliance must now be attested annually through submission by each agency of IRS Form 9990 – have a pathway that secures them in the knowledge that they are setting compensation amounts that the IRS will consider presumptively reasonable and not excessive.

It is our strong belief that community providers’ boards are following these provisions very closely through board governance principles that align with the spirit and the letter of the IRS provisions. After all, it hardly needs to be stated that loss of not-for-profit status would be catastrophic for these providers. (DD providers in New York, for example are required to be not-for-profit entities if they are to provide services under license from the state OPWDD.)

The IRS approach has several virtues that more rigid provisions lack. Boards must exercise due diligence in studying comparative data that assists them in setting salaries. This ensures that executives are compensated after adjustments – up or down – that are consonant with the data the boards gather from similarly situated providers with similarly experienced, educated, and credentialed executives. This comparative data approach thus indirectly, but effectively, takes into account geographic factors, education levels of similar executives, other credentials, longevity of service, and the market value of such individuals. And, by requiring a board to take pains to document the comparative data study, the IRS thus has easily analyzed data in which to make a determination of reasonableness and to help ensure that boards do not act arbitrarily, in secret, or without proper basis for the compensation level it approves.

It should be noted that, much as state-imposed compensation limits are designed to protect the public purse, the IRS approach is designed in the same spirit. The IRS in this case polices whether not-for-profits are abusing a status that confers a social subsidy on them. We think it is significant that the IRS has chosen a path that balances many factors – among them, the protection of taxpayers.

This approach also comports with a New York State manual of best practices that was recently prepared. The April 2010 “Report on Executive Compensation” published by the New York State Commission on Quality of Care and Advocacy for Persons with Disabilities (CQCAPD), speaks approvingly of governing boards’ reliance upon data from IRS Form 990 when setting compensation levels, as it is the most common public source of compensation data. The report also recommends comparing “similar jobs, at agencies of similar purpose, revenue size and geographic area.” The report reiterates these values by citing three key factors that influence executive compensation: size of agency budget, geographic region and “personal factors” such as education and an individual’s years of experience. Thus, the report endorses the same sorts of factors that the IRS expressly notes as criteria under its reasonableness tests.

NYSRA and its member agencies feel quite strongly that the State has a significant interest in ensuring its fiscal investment in provision of services and supports is protected. All of our member agencies, as well as our association itself, operate with missions that are service-related and centered on the individuals who are served, not the welfare of provider agency executives.

At the same time, providers, like all other effective businesses, must contend with challenges of recruitment and retention of talented, qualified and effective individuals to help ensure that services of the highest quality are made available to New Yorkers. Any limitations must be viewed from a perspective of whether they will ultimately drive quality people from the provider systems.

While we recognize the intent of proposals such as those advanced by the Governor, we caution against policies or legislation that, while they appear to be effective responses to a problem – in this case, a problem we can only conclude is isolated to a very few instances – may in fact instigate other problems. Flat limits, for instance, could conceivably drive up salaries that are already lower than the prescribed restriction. Rigid provisions can work injustices because they lack the capacity to be applied equitably. Caps on state reimbursement of salaries can mean that talented, innovative, and truly effective leaders leave our systems behind once they become so valuable as to be too expensive for our community providers to retain them.

Efficient government and taxpayer protection are, as we noted, important priorities for policymakers. However, we must also be mindful of our shared goal of ensuring that quality services and supports play a major role in shaping our system as we move forward. That is why we endorse the IRS approach. It protects taxpayers while it remains sensitive to the various real-world factors that well-meaning governing boards deal with when finding and compensating leaders. We believe it is far more effective than a “one-size” approach when seeking to balance the varied interests implicated by this issue.

NYSRA sincerely thanks Senator Marcellino, this Committee and the Senate leadership for the opportunity to air our views on this significant and important issue.