

## New York State Focuses on Compensation of Not-for-Profit Executives and Board Members

On August 3rd New York Governor Andrew Cuomo announced that he had created a “Governor’s Task Force on Not-for-Profit Entities” to investigate the compensation of not-for-profit executives and Board members. This action was precipitated by “reports of startlingly excessive salaries and compensation packages for executives at not-for-profits that depended on state Medicaid funding through the Office of People With Developmental Disabilities (OPWDD) and other State agencies.”

As the Task Force’s first public act, on August 15th its Chairman, Benjamin M. Lawskey, sent a letter to the Board members of fifty not-for-profit corporations. At this time we believe that all fifty not-for-profits that were sent this letter are OPWDD providers. However, according to a quote from Chairman Lawskey, “[o]ur plan is to look at all non-profits that receive significant state funds.” Thus, other not-for-profit entities in New York, including hospitals, colleges, universities, and charities, can expect to receive the same or a similar letter in the near future.

According to the letter, the Task Force is “conducting a top-to-bottom review, not only to audit current compensation levels, but also to make recommendations for future rules to ensure taxpayer dollars are used to serve and support the people of this state, not pay excessive salaries and compensation.” According to a quote from Mr. Lawskey, “[t]he question becomes what justifies each group’s nonprofit status, what justifies them getting these tax breaks and large state grants, and then how are they spending the money that they get.” The letter states that it is being sent to the “Board of Directors . . . as the not-for-profit’s top management likely has a significant interest in the size of their compensation.” The letter includes thirty-nine questions, with subparts, asks that responses to twenty-four questions be provided on Excel spreadsheets, and requires a response by September 15th. The information requested covers the last four and one-half years.

Among the more pointed questions are these:

- “34. Do you believe that recoupment and/or claw-back of executive and/or board compensation is necessary?
- 36. [I]s the board or management considering any recoupment and/or claw-back for past salary and/or benefits?
- 38. What justified the compensation to executives?
- 39. What justifies you being a not-for-profit?”

Receipt of this letter will likely cause great concern among members of not-for-profit Boards of Directors. Whether and how to respond to the letter should be discussed with counsel. Much of the information requested is already submitted to the Internal Revenue Service on each organization's annual tax return ("Form 990"). For example, the letter asks for "[a]nnual total number of employees with base salaries of over \$100,000." Form 990 requires the same information. The letter also asks for the name, job title, start date, annual base compensation, annual bonus, annual total of other forms of compensation (i.e., incentive compensation, benefits, cars, travel, hotel expenses, etc.), annual deferred compensation, and average hours per work week of each executive, administrator, and board member, as well as any other individual that received over \$100,000 in total compensation. Again, Form 990 requires substantially similar information.

Given the Internal Revenue Service's existing regulatory structure with respect to executive compensation, federal law can be instructive in framing many of the issues raised by the Task Force's letter. In general, federal law requires that a not-for-profit organization's compensation arrangements be reasonable. The Internal Revenue Code provides a two-part test for determining the reasonableness of a compensation arrangement. First, the payment of compensation must be reasonable and necessary to carrying out the organization's purposes. Second, the payment of compensation cannot be excessive. Treasury Regulations provide that compensation is reasonable if it is "such an amount as would ordinarily be paid for like services by like enterprises under like circumstances." There is a rebuttable presumption of reasonableness if the following conditions are satisfied:

- (1) the compensation arrangement is approved in advance by disinterested members of an authorized body of the organization;
- (2) the authorized body obtained and relied upon appropriate data as to comparability prior to making its compensation determination; and
- (3) the authorized body adequately documented the basis for its determination concurrently with making its determination.

Although organizations are generally advised to follow the presumption of reasonableness procedures, compensation arrangements can be reasonable without meeting the presumption of reasonableness. If an organization has utilized the presumption of reasonableness procedures, the supporting documentation for its compensation arrangements can act as a roadmap for answering many of the Task Force's questions.

Whether your organization has received the letter already, or whether it receives it later, the letter clearly is intended to cause a discussion within the Board about the appropriate levels of compensation within the context of your not-for-profit's mission. If your Board has already received the letter, executive leadership, and in particular the Chief Financial Officer, should actively support the Board in answering its questions by providing access to the required information. If your organization has not yet received the letter, Board members should begin thinking about whether and how the organization will respond, and should arrange access to the information required to expeditiously answer the questions posed in the letter.

If you have any questions, please contact:

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