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COMMITTEE FOR PURCHASE FROM PEOPLE WHO ARE BLIND OR SEVERELY DISABLED

41 CFR Parts 51-2, 51-3, and 51-4

Nonprofit Agency Governance and Executive Compensation

AGENCY: Committee for Purchase From People Who Are Blind or Severely Disabled.

ACTION: Advanced notice of proposed rulemaking: Request for comments and notice of public hearings.

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SUMMARY: The Committee for Purchase From People Who Are Blind or Severely Disabled (the Committee) is considering revising its regulations regarding: The qualifications required of both central nonprofit agencies and nonprofit agencies to participate in the Javits-Wagner-O'Day (JWOD) Program, and the guidelines under which executive compensation will be considered as either influencing or not influencing a fair market price. The Committee wants to ensure that Federal customers continue to receive high value products and services from JWOD affiliated central nonprofit agencies and nonprofit agencies and believes that these two areas merit further review at this time.

Prior to initiating any formal rulemaking, the Committee is seeking further information and suggestions on: alternative approaches to determine that central nonprofit agencies and nonprofit agencies are initially qualified to participate in the JWOD Program and then qualified to continue to participate in the Program, and alternative approaches and mechanisms to assess that the fair market price set by the Committee and paid by Federal departments and agencies is not burdened inappropriately by excessive executive compensation costs.

DATES: The Committee will hold three public hearings. Hearings will be held on Thursday, January 12, 2006, in Arlington, VA; Thursday, January 19, 2006, in Dallas, TX; and Thursday, January 26, 2006, in San Francisco, CA. Written comments from those that do not attend the hearings are also welcomed and must be received by January 31, 2006. The Committee will not consider comments pertaining to these hearings that are received after January 31, 2006.

ADDRESSES: The specific locations and times where the hearings will be held are:

1. Thursday, January 12, 2006, from 2 p.m. to 5 p.m., Crystal Gateway Marriott, 1700 Jefferson Davis Highway, Arlington, VA 22202.
2. Thursday, January 19, 2006 from 10 a.m. to 1 p.m., Red River Conference Room (7th Floor, Room 752). Earl Cabell Federal Office Building, 1100 Commerce Street, Dallas, TX 75242.
3. Thursday, January 26, 2006, from 10 a.m. to 1 p.m., California/Nevada Room, Phillip Burton Federal Building, 450 Golden Gate Avenue, San Francisco, CA 94102.

The Committee office is located at Jefferson Plaza 2, Suite 10800, 1421 Jefferson Davis Highway, Arlington, VA 22202-3259.

FOR FURTHER INFORMATION CONTACT: For information about the hearings, submitting requests to testify, or submitting written comments contact Stephanie Hillmon, Assistant General Counsel, by telephone (703) 603-7740; by facsimile at (703) 603-0030; by e-mail at [RulesComment@jwod.gov](mailto:RulesComment@jwod.gov); and by mail at the Committee for Purchase From People Who Are Blind or Severely Disabled, 1421 Jefferson Davis Hwy., Suite 10800, Arlington, VA 22202-3259. Office hours are between 7:30 a.m. and 5 p.m., eastern standard time, Monday through Friday except Federal holidays.

SUPPLEMENTARY INFORMATION: Pursuant to its statutory authority to determine suitability and the fair market price, the Committee plans to issue regulations that ensure that only qualified central nonprofit agencies and nonprofit agencies participate in the JWOD Program and that the fair market price charged to Federal customers is both reasonable and appropriate.

#### Public Hearings:

Requests to testify must be received at the Committee office at least one week prior to the hearing date. Requests to testify should also indicate which hearing will be attended. Persons interested in providing oral testimony are encouraged, but not required, to submit written comments a week in advance of the hearings and testimony will be limited to the matters contained in this notice. The Committee staff will moderate the hearings. In the event that more people ask to testify than can be accommodated in the time allowed, the Committee will hear testimony from a cross-section of those wishing to testify, as determined by the Committee staff. Only one person from a particular organization may testify. Oral testimony shall not exceed 5 minutes.

The public hearings and comment period are for the purpose of gathering information about implementing better mechanisms to ensure that only qualified central nonprofit agencies and nonprofit agencies participate in the JWOD Program and that the fair market

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price established by the Committee is not affected by inappropriate executive compensation costs. The Committee plans to develop regulations that will achieve these objectives. The hearings are not intended as a forum for presentation or discussion of other issues to include the Committee's authority, redundancy, and similar issues. Testimony will only be heard and comments will only be considered that address the questions listed in this notice. In preparing testimony or written comments, the public is asked to address the questions presented below:

#### Background Information

The Committee administers the JWOD Act, which leverages the Federal procurement system to provide employment for over 45,000 persons who are blind or have other severe disabilities. In Fiscal Year 2004, Federal customers purchased over \$2 billion of goods and services from about 650 participating nonprofit agencies nationwide. The Committee anticipates additional growth in both the numbers of people employed through the program and in the dollar value of Federal funds used to purchase goods and services. The Committee strongly believes that accountability, stewardship, and value

form the foundation for maintaining and growing employment opportunities for people who are blind or have other severe disabilities. With the increasing size, scope, and complexity of the JWOD Program, the Committee believes it is appropriate to review its regulations and policies to insure proper accountability standards, provide effective stewardship, and demonstrate a strong value proposition for Federal customers.

As established in 41 U.S.C. 47(a)(2), the Committee determines the suitability of products and services which, if added to the Committee's Procurement List, must be purchased by Federal departments and agencies requiring those items or services. Under the Committee's regulations, 41 CFR 51-2.4(a), there are currently four criteria used to assess the suitability of a proposed product or service: (1) The potential for employing people who are blind or severely disabled; (2) the qualifications of the nonprofit agency; (3) the capability of the nonprofit agency to meet Government quality standards and delivery times; (4) and the level of impact on the current or most recent contractor if the product or service were to be added to the Procurement List. The Committee has statutory authority to determine which central nonprofit agencies and nonprofit agencies are qualified to participate in the JWOD Program. The Committee is considering revising its regulations concerning the qualifications required of both designated central nonprofit agencies and all other nonprofit agencies to participate in the JWOD Program. The Committee is interested in identifying and applying qualification standards through which central nonprofit agencies and participating nonprofit agencies would demonstrate good governance practices and therefore be qualified to participate in the Program.

If a proposed product or service is determined to be suitable, the Committee has the sole responsibility under the JWOD Act to set the fair market price to be paid by the Government customer. The Committee is also seeking information on suggested criteria to identify and evaluate the impact of executive compensation costs on any proposed or recommended fair market price.

#### Qualified Agencies Have Good Governance Practices

There are a number of criteria and tests that are widely considered as benchmarks of good nonprofit agency governance practices. The Committee believes the following to be representative of such ``best practices'' but not all-inclusive:

(1) The board of directors (the board) should be composed of individuals who are personally committed to the mission of the organization and possess the specific skills needed to accomplish the mission.

(2) Where an employee of the organization is a voting member of the board, the circumstances must insure that the employee will not be in a position to exercise ``undue influence.''

(3) The board should have no fewer than five unrelated directors. Seven or more directors are preferable. The board chairperson should not also be serving as the nonprofit agency's CEO/President.

(4) The organization's bylaws should set forth term limits for the service of board members.

(5) Board membership should reflect the diversity of the communities served by the organization.

(6) Board members should serve without compensation for their service as board members. Board members may be reimbursed only for expenses directly related to carrying out their board service.

(7) The full board or some designated committee of the board should hire the executive director, set the executive's compensation, and evaluate the director's performance at least annually. In cases where a designated

committee performs this responsibility, details should be reported to the full board.

(8) The board should periodically review the appropriateness of the overall compensation structure of the organization.

(9) The full board should approve the findings of the organization's annual audit and ``management letter'' and approve a plan to implement the recommendations of the management letter.

(10) Nonprofits should have a written conflict of interest policy. The policy should be applicable to board members and staff, who have significant independent decision-making authority regarding the resources of the organization. The policy should identify the types of conduct or transactions that raise conflict of interest concerns, should set forth procedures for disclosure of actual or potential conflicts, and should provide for review of individual transactions by the uninvolved members of the board of directors.

(11) The accuracy of the agency's financial reports should be subject to audit by a Certified Public Accountant. The board of directors should have at least one ``financial expert'' serving;

(12) Nonprofit agencies should periodically conduct an internal review of the organization's compliance with existing statutory, regulatory and financial reporting requirements and should provide a summary of the results of the review to members of the board of directors.

(13) Nonprofit agencies should prepare, and make available annually to the public, information about the organization's mission, program activities, and basic audited (if applicable) financial data. The report should also identify the names of the organization's board of directors and executive management staff.

(14) Executive compensation paid to the Chief Executive Officer (CEO)/President and ``highly compensated individuals'' must be monitored by the board of directors. The full board should approve all compensation packages for the CEO/President and all highly compensated employees through a ``rebuttable presumption'' process to determine reasonableness.

The Committee is seeking further information and perspective in the following areas related to governance practices:

(1) Are these criteria comprehensive and inclusive enough to effectively evaluate that a nonprofit agency demonstrates good governance practices

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and should be deemed qualified to participate in the JWOD Program?

(2) Are there additional criteria that should be used, or substituted for the above, to evaluate evidence of good governance practices by nonprofit agencies in the Program?

(3) Should accreditation by one or more state or national organizations be recognized as evidence of a nonprofit agency adhering to good governance practices without further review by the Committee?

(4) Should different benchmarks be used for nonprofit agencies that are state, county, or local government agencies, or should they be exempt from any Committee regulations in this area?

(5) Should the size and/or the annual revenue of the nonprofit agency be a factor or factors in assessing appropriate governance practices?

(6) What is the best way to ensure that only qualified central nonprofit agencies and nonprofit agencies, with an internal structure that minimizes opportunities for impropriety, participate in the JWOD Program?

(7) What if any enforcement mechanisms should be adopted to ensure only the qualified central nonprofit agencies and nonprofit agencies participate in the JWOD Program?

(8) What steps will the nonprofit agencies and central nonprofit agencies need to take to avoid conflicts of interest among its board members?

(9) What steps will the nonprofit agencies and central nonprofit agencies have to take to demonstrate financial responsibility?

#### Effect of Executive Compensation on Fair Market Price Determinations

Board involvement in setting the compensation of the CEO/President and other highly compensated employees is one of the benchmarks of effective nonprofit governance practices. In furtherance of assessing information used to set the initial fair market price for products and services added to the Procurement List, and then periodic adjustments to the price thereafter, the Committee is seeking information on the following:

(1) What is the threshold beyond which the compensation paid to the executives in a JWOD-participating nonprofit agency should be considered as influencing a proposed fair market price determination? For example, if the agency receives more than a certain percentage of its total revenue from sales through the JWOD Program, is there a compensation level (total dollars paid or total dollars paid as a percentage of total revenue) at and above which fair market price impact would be deemed to occur?

(2) Conversely, is there a point below which executive compensation, regardless of the dollar amount paid, would not be considered as influencing a recommended fair market price? Is such a de minimis test appropriate for large diversified nonprofits where total JWOD sales represent only a small percentage of total revenue?

(3) Without regard to any analysis of JWOD-related revenue, is there an established benchmark or absolute dollar threshold above which compensation would be deemed as influencing a proposed fair market price?

(4) Should receipt of documentation to support a ``rebuttable presumption of reasonableness'' serve to demonstrate that executive compensation does not by itself influence a proposed fair market price or any adjustment thereto?

(5) To what extent should there be a relationship between the pay and compensation of line workers and highly compensated individuals?

(6) At what point would be appropriate to begin a review of an executive compensation package even if the proposed price for a product or service would fall within a range that it could be considered as a fair market price?

(7) What approaches are available to identify and monitor nonprofit agencies executive compensation that would provide such information to the Committee routinely but without placing an undue burden on agencies?

#### Definitions of Terms in Quotation Marks Above

(1) A ``financial expert'' is a director that must understand GAAP and financial statements, have the ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves, have experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the registrant's financial statements, or experience actively supervising one or more persons engaged in such activities, have an understanding of internal controls and the procedures for financial reporting, and have an understanding of audit committee functions.

(2) A ``rebuttable presumption of reasonableness'' requires the maintaining a board of independent members, requires the Board of Directors to approve compensation arrangements for highly paid executives and individuals using independent comparative salary data gathered from similar

organizations for similar executive positions, and documents all data used in decision making for compensation packages including all annual compensation, incentive compensation plans, long-term incentive plans, supplemental retirement plans, wrap-around Section 401K plans, deferred compensation arrangements and benefits.

(3) A ``highly compensated individual'' is an individual:

(i) With a year's compensation in excess of \$90,000.00; or

(ii) Who had compensation within the previous year which was in excess of \$90,000.00; or

(iii) At the election of the employer had compensation in excess of \$90,000.00 and was in the top 20 percent of employees by compensation for any year.

(4) ``Undue influence'' is prohibited and occurs when an officer, director, or employee of the agency directly or indirectly takes any action to coerce, manipulate, mislead, or fraudulently influence the agencies' audit committee, Directors, CEO/President or any individual that has authority or power to influence the preceding persons.

(5) A ``management letter'' is a technical letter, which is prepared by an auditor or audit committee.

Patrick Rowe,

Deputy Executive Director, Committee for Purchase From People Who Are Blind or Severely Disabled.

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